INITIAL PUBLIC OFFERINGS IN SAUDI ARABIA: MOTIVATIONS, BARRIERS, AND EFFECTS

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To the memory of my mother

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Abstract

This research has taken the form of a field study to gather empirical evidence capable of providing an overview of current initial public offerings (IPOs) in Saudi Arabia.

The main thrusts of this thesis are: to identify empirically the motivations for going public in Saudi Arabia; to find the barriers to going public in the Kingdom; to investigate the effects of IPOs on the performance of companies; to investigate the relationship between an increase in the number of IPOs and economic performance; to find which kind of companies are more likely to go public in the country; and to identify some suggestions which could increase the number of IPOs in Saudi Arabia.

To answer the research questions, the researcher undertook three studies. Firstly, data was collected through a case study of a single company that had made an IPO in the Kingdom. Financial ratio analysis was employed to capture the changes in the financial statements before and after the IPO, and two in-depth interviews were conducted with the company's CEO and financial manager to discuss the financial changes and other IPO issues. Secondly, more data was gathered through a comprehensive questionnaire. The sample studied in the questionnaire was taken from the top management of the 500 largest companies in Saudi Arabia. A total of 145 companies from 7 different business sectors in Saudi Arabia participated in the study. This represented a response rate in excess of 29%. Thirdly, extra data was obtained from personal interviews with three well-experienced and educated businessmen who have taken their companies public.

The results obtained from the single case study, the questionnaire, and the interviews showed firstly, that companies in Saudi Arabia are motivated to go public in order to use the money raised for more expansion and growth, to be more competitive, and to separate the company's life from that of the previous owners.

Secondly, with regard to the most important barriers to going public in the Kingdom, the study finds that private firms are reluctant to go public because of the failure of many joint stock companies listed on the Saudi Stock Market to generate profit; because of the possible loss of control; and because of the lengthy procedure for going public. Thirdly, this research also discovers that whereas most of the questionnaire survey participants believed that IPO performance would decline after the transition, and also confirmed by the results from the case study, the interviewees thought that performance would improve after the IPO.

Fourthly, with regard to the effect of IPOs on economic conditions, there is a great consensus between the questionnaire participants and all the interviewees on that an increased number of IPOs in Saudi Arabia would have a favourable effect on economic welfare. An increase in joint stock companies in the Kingdom would improve several economic factors, such as the growth rate, foreign investment, the balance of trade, and the unemployment rate.

Fifthly, this research also finds that while most of the questionnaire survey respondents thought that companies owned by more than one investor and large companies (in terms of size) are more likely to go public, most of the interviewees believed that companies working in industrial sector are more probably to seek public equity.

Sixthly, this research finds that the rate of going public in Saudi Arabia could be improved if the government creates a complete financial system, prepares clear guidelines that explained the procedures for going public, and eases the procedures for IPOs. The rate of going public in Saudi Arabia also could be improved if the decision makers in private firms separate management from ownership and hire professional personnel to lead the companies.

In conclusion, the study suggests that since going public would add many advantages to firms, like strengthening financial position, increasing public trust, and attracting well qualified personal, the flotation decision could solve some of the problems that the Saudi private sector has, such as severe competition, poor management, constraints of finance, and generation shift (lock of family succession and control). Nevertheless, the study also confirms that IPOs would create new problems, especially that of more restrictions on private transactions.

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1.1 Background

An initial public offering (IPO) is a first-time offering of shares by a specific firm to the public (Madura, 1998). IPOs tend to occur more frequently during bullish stock market periods, when potential investors are more interested in purchasing new stocks. They also occur more when other investment opportunities are not as attractive to investors. For instance, in the USA in the mid-1990s, the stock market was bullish, but low interest rates discouraged investors from investing in interest-bearing instruments such as bonds. Consequently, investor demand for new stocks was strong. Firms at that time were more willing to engage in IPOs since they were confident that they could sell all of the shares. Moreover, in the second quarter of 1996, IPOs in the USA generated about $16 billion for firms, which set a record for the dollar volume of IPOs in a single quarter (Madura, 1998).

Unsurprisingly, IPO activity has attracted the attention of academics and policy makers, producing a substantial amount of research in the financial literature. Previous studies on IPO activity have focused on several issues, such as the operating performance of IPOs, the initial underpricing, the long run performance of IPO stocks, the pros and cons of an IPO, the relation between the economy and the IPOs, and the characteristics of the IPOs.

With regard to the performance of IPOs, the majority of studies have found that the operating performance of IPOs declines after going public. Most of these studies, such as Degeorge *et al.* (1993), Cai and Wei (1997), Mikkelson *et al.* (1997), and Pagano *et al.*

(1998), attributed the decline to the window of opportunity: companies go public when entrepreneurs recognise that other companies in their industry are overvalued. Other studies, like Jain and Kini (1994), and Kutsuna *et al.* (2002), attribute this decline to the change in ownership structure. On the other hand, a few researchers have found that IPOs improve their performance. For example, Holthausen and Larcker (1996) found that the accounting performance of reverse LBOs was significantly better than that of the median in their industries in the year prior to and in the year of the IPO, and they found that the reason behind this improvement was the change in ownership structure.

In addition, like any other decision, the decision to go public has its advantages and disadvantages. When a company is listed on the stock market, it has access to new sources of finance, with concomitant improved prospects for growth and expansion (Ransley, 1984; Jain and Kini, 1994; McConaughy *et al*, 1995; Rydqvist and Högholm, 1995; Holthausen and Larcker, 1996; Mikkelson *et al.*, 1997; Kutsuna *et al.*, 2002; and, Kim *et al.*, 2004). Access to security markets may reduce the cost of credit (Rajan, 1992, and Pagano *et al*, 1998). When the shares of a company are publicly traded, the owners can easily liquidate and diversify their investment by trading in the stock market (Ransley, 1984; Jenkinson and Espenlaub, 1991; Pagano, 1993; Rydqvist and Högholm, 1995; Brennan and Franks, 1997; Cai and Wei, 1997; Mikkelson *et al.*, 1997; and, Kutsuna *el al.*, 2002). Moreover, going public gives IPOs an opportunity to offer vendors, suppliers, and employees stock or stock options, giving these individuals a stake in the company's success and a reason to act to advance that success (Ransley, 1984, and Hare, 1994). Being open to public scrutiny, public companies tend to be better known and are likely to be accepted more easily as trustworthy and dependable. The reputation and

visibility they gain as public companies can help them to win customers, secure financing, or expand from a regional company to a national one (Ransley, 1984, and Rydqvist and Högholm, 1995). In addition, companies can use the money raised from selling the stock to outsiders to pay their debt (Mikkelson *et al.*, 1997, and Pagano *et al.*, 1998).

On the other hand, by going public, the founders might lose control of the company and cease to be the decision makers (Rydqvist and Högholm, 1995; Zingales, 1995; Cai and Wei, 1997; Mikkelson *et al.*, 1997; and, Pagano *et al.*, 1998). By listing in the stock market, companies have to disclose more information about their financial and managerial status (Choi, 1973; Campbell, 1979; Firth, 1979; Leftwich *et al.*, 1981; Ransley, 1984; Cooke, 1992; Malone *et al.*, 1993; Wallace *et al.*, 1994; Yosha, 1995; and, Pagano *et al.*, 1998). Finally, there are a great number of direct costs (underwriting fees, accounting and consulting fees, register fees, etc.) associated with going public. Underwriters typically take at least 7% of gross proceeds (Lee *et al.*, 1996, and Ritter, 1998).

Some studies have tried to establish the characteristics of IPOs. Matsuda *et al.* (1994) conducted a study to find the differences between Japanese and US firms that had completed initial public offerings. They found that, statistically, the differences between Japanese and US IPOs were in age and size. Japanese IPOs were older and larger than their US counterparts. These results also showed that the percentage of manufacturing firms in both groups was high, 62.5% in the US and 55.7% in Japan. Ritter (1991) reported that the median age of a sample of US IPOs, which went public between 1975

and 1984, was just 6 years, and the median for sales was 11.55 million dollars. Rydqvist and Högholm (1995) conducted a study in Sweden on companies that went public between 1970 and 1991, and found that at the time of the IPO, the firms they studied were old. The average age was 38 years. They also concluded that the average firm was large at the time of going public, and they also found, on average, that the assets of IPOs are financed almost 50% from debt and 50% from equity. They found that the most frequent businesses involved in IPOs are in manufacturing and services. Agriculture, mineral production, and heavy industry are rare. Cai and Wei (1997) examined 180 IPO firms listed on the Tokyo Stock Exchange during the 1971-1992 period, and found that the average IPO size in their sample was 441 million dollars while the average industry median was 377 million dollars. They showed that these IPOs were larger than the average for their industry. Torres (1997) found statistically that larger, more profitable firms and firms in sectors with higher market-to-book ratios are more likely to make an IPO, and companies with less access to sources of debt finance are more likely to choose to become listed.

Regarding the effect of an increased number of IPOs on the economy, few studies have investigated this matter. Rousseau and Wachtel (2000) believe that a stock market listing can improve economic performance, because the stock market can provide an exit mechanism to venture capitalists; offer liquidity to investors, encourage international diversification and portfolio flows; provide firms with access to permanent capital which can then be placed in large, indivisible, projects; and generate information about the quality of potential investments.

Atje and Jovanovic (1993) found stock markets had a strong and positive effect on growth over the period 1980-1988 for 40 countries. Levine and Zervos (1998) found that stock market liquidity has a positive and significant correlation with current and future rates of economic growth. They also found that market size and international integration are not strongly correlated with growth. Rousseau and Wachtel (2000) found that the stock market is a significant factor in promoting economic growth. Specifically, their findings indicate that the size of the market alone is less important for growth in per capita incomes than the liquidity of the market and its interaction with size.

Finally, previous literature has focused on IPO activity in developed countries, especially Japan, the UK, and the USA. IPO research conducted in developing countries is very rare. Therefore, this study aims to fill part of this gap by investigating the motivations, barriers, and effects of IPOs on firms and economy and the characteristic of the IPOs in Saudi Arabia.

1.2 Statement of the problem and primary research questions

Some well-respected business people and government officials in Saudi Arabia think that private firms can strengthen their position in local, regional, and international markets and solve their problems by going public. In addition, they believe that if the Kingdom had more IPOs, that would improve economic performance. However, others believe that the decision to go public is reached for personal benefit, and therefore would not solve private sector problems or improve Saudi economic performance.

This study attempts to find answers to the following questions:

1. What are the motivations for going public in Saudi Arabia?
2. What are the barriers that affect the rate of going public in Saudi Arabia?
3. What are the effects of going public on companies' performance?
4. What are the effects of an increase in joint stock companies on the Saudi economy? [1]
5. What are the characteristics of IPOs in Saudi Arabia?

1.3 Objectives of the study

To the best of the researcher's knowledge, this is the first time that such an investigation has been undertaken in Saudi Arabia. The thesis is carried out in order to achieve several objectives. The main objectives of the study are to:

- Explore the motivations and barriers affecting the rate of IPOs in Saudi Arabia
- Find the effect of IPOs on companies' performance
- Investigate the impact of an increased number of IPOs on the Saudi economy
- Find if the decision to go public is associated with particular kinds of companies
- Make some suggestions which could help to increase the rate of IPOs
- Contribute to the literature of finance about IPO activity in developing countries

At last, the participants in this thesis were asked if they wanted to receive a final report of the main findings and recommendations. A large number of people, 81%, indicated their wish to receive such a report. The importance of the study can be assessed from this,

[1] There is alternative view which the direction of causality which the economy would stimulate the creation of the IPOs. But, observes its effect in the current study will not be addressed.

since the Saudi public and private sectors have a lack of studies investigating the decision to go public and its impact on firms and the economy.

1.4 The motives of the study

Many motives were behind the decision to conduct this study. Some of the motives were:

- The researcher's great desire to study the subject
- The interest of many other parties in this subject
- The shortage of IPO studies conducted in developing countries, particularly in Saudi Arabia
- The increased number of IPOs in the Kingdom in recent years

1.5 Thesis progression and organisation

The researcher in this study realised from the beginning that the lack of existing studies examined the IPO issues in the Kingdom would be a great obstacle. However, to overcome this problem and achieve the research objectives, the researcher will conduct a comprehensive review on two fundamental axes. First, the study will provide essential information about the Saudi economic condition, the market competition in the Kingdom, the development of Saudi Stock Market, and the procedures of going public in Saudi Arabia. These subjects and their possible impacts on the going public activities in the Kingdom are covered in three chapters (Chapter Two, Three, and Four). Second, the research also will review the IPO existing literature (Chapter Five). The majority of

studies presented in Chapter Five were conducted in other counties, especially developed countries, which have experience with IPO activities.

By giving a full picture of the Saudi business environment and its possible effects on the IPO activities in the country and also by reviewing most of the IPOs existing literature, the researcher in this study is able to select and develop reliable and valid data collection methods, employ the most appropriate data analysis techniques, and confirm and justify the findings and results. Figure 1-1 shows the flow chart of the progression of the current thesis.

Finally, the thesis is structured into ten chapters divided into three parts.

Part one is a framework part, with four chapters of background.

Chapter One: Introduction

This outlines the framework of the thesis. It lays out research problems, the objectives of the study, and the organisation of the thesis.

Chapter Two: Saudi Arabian economic development

This deals with the development of the Saudi economy, the role of the Saudi Arabian government in the economy, the contribution of the private sector to the economy, and competition in the Kingdom.

Chapter Three: The development of the Saudi Stock Market (SSM)

This deals with the development of the Saudi Stock Market (SSM), the important roles of the Saudi Arabian Monetary Agency (SAMA), the development of the SSM in terms of

primary and secondary markets, the main stock market sectors, the SSM participants, characteristics, and efficiency.

Chapter Four: The procedures for going public in Saudi Arabia

This deals with the procedures for going public in Saudi Arabia. It also encompasses the Companies Act as the first body of regulations to set rules for general requirements for going public. The requirements that companies have to meet to convert to joint stock corporations are reviewed.

Part two of the study consists of two chapters. It provides information on the related review of literature and the methodology of the study.

Chapter Five: Literature review

This chapter investigates previous studies related to IPO activities, the advantages and disadvantages of going public, the performance and characteristics of the IPOs, and the relationship between the economy and IPOs.

Chapter Six: The research methodology

This presents the methodology used in this research. The advantages and disadvantages of the methods used are discussed. There is detailed discussion of the methods used and the reasons for this choice.

Part three contains four chapters. This part provides information about the results and discusses the findings.

Chapter Seven: The case study – comparative financial analysis between the years before and after the IPO

This is a single case study on a company that went public. There is background information about the company under investigation, financial analysis of its financial statements, and results from interviews held with the company's officials.

Chapter Eight: The analysis and results of the questionnaire and interview data

This chapter presents results obtained from a questionnaire and three interviews with businessmen who experienced IPOs. The statistical tools that were used in analysing the results from the questionnaire are discussed.

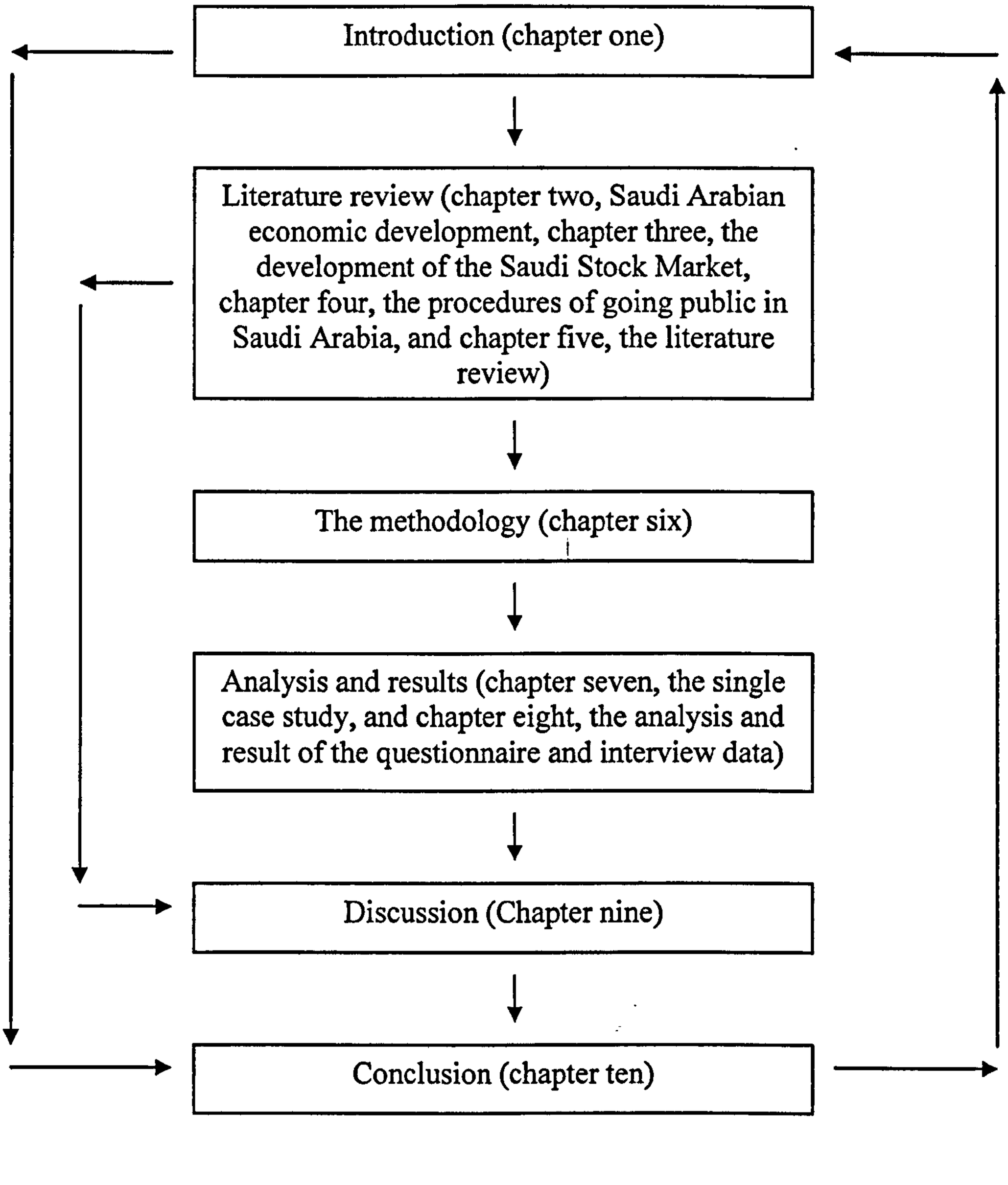
Chapter Nine: Discussion

In this chapter, there is justification of the results obtained from the single case study, the questionnaire, and the interviews.

Chapter Ten: Conclusion

This presents a summary of the study findings, the implications of the study, the boundaries of the study, and recommendations for future research.

Figure 1-1 The flow chart of the progression of the current thesis



2.1 Introduction

On the 23rd of September 1932, the Kingdom of Saudi Arabia was founded and unified by King Abdulaziz Al-Saud. The rules, judgements, and decisions of the country are based on what is stated in the Holy Qur'an and on the Sunna (Practices of the Prophet Mohammed; peace be upon him). The Kingdom of Saudi Arabia comprises about four-fifths of the Arabian Peninsula. The size of the country is 2,250,000 square kilometres (868,730 square miles). It shares borders in the north with Jordan, Iraq, and Kuwait; with Oman and Yemen to the south; Bahrain, Qatar, the United Arab Emirates, and the Arabian Gulf to the east; and to the west, the Red Sea. The population of the Kingdom is 21.4 million and the country is divided into thirteen administrative regions (Ministry of Information, 2000).

The information provided in this chapter is a continuation of information collected during the exploration stage. This chapter is essential since it contains information which will show clearly that Saudi Arabia has unique characteristics which may contribute to the motivations for going public, barriers to going public, and effects of IPOs.

As noted in the Introduction Chapter, this study has several aims and one of these aims is to ascertain if an increased number of IPOs may have an effect on the economic factors. Therefore, the second section of this chapter involves Saudi economic history, and the main Saudi macroeconomic variables, such as GDP growth, which is believed to have a great effect on the demand for IPOs.

The third section presents the contribution of the government to the economy by reviewing new government regulations and policies which could encourage the private sector to engage more in the economy, strengthen the Saudi Stock Market, and increase the number of IPOs. This section also reviews the five-year development plans.

The fourth section of this chapter reviews the contributions of the private sector to the economy. This part shows the development of the private sector and its current role in the Saudi economy. As also discussed in the Introduction Chapter, this study aims to find if IPOs may help solve the private sector's problems. Thus, this section presents these challenges and problems and also examines if they can be solved by going public. Furthermore, the classification of companies operating in the Kingdom and the number of JSCs compared to the whole number of companies will be presented in this section.

Finally, the fifth section reviews the competitive advantages of Saudi Arabia using Porter's model as the level of the competition is thought to be an important factor affecting the rate of the IPOs and the performance of the firms before and after the flotation.

2.2 The economic background and the macroeconomic variables

2.2.1 Economic background

The economic system in Saudi Arabia is based on free and private enterprise. Saudi citizens can initiate and participate in economic activities and they have the right to reap the rewards of their enterprises. Private property is respected and anyone is free to engage in the economic field.

In 1938, the Californian Arabian Standard Oil Company (which was re-named in 1944 as the Arabian American Oil Company, ARAMCO) discovered oil. Saudi Arabia possesses a quarter of the world's proven oil reserves and is the largest exporter of oil in the world, with capacity for producing 10 million barrels a day.

Before 1938, the Saudi economy depended on the pilgrimage to Mecca in the western area; subsistence farming in the few agricultural regions in the southern, central, and eastern regions; and pearling along the eastern coast. After World War II, oil quickly became the most important source of revenue in the Kingdom. In the early 1970s, the Saudi government started a long-term programme to benefit from its oil revenues.

In the 1970s and 1980s, the government was the major player in establishing basic infrastructure and institutions. From the early 1970s until the early 1980s, the government invested heavily to modernise the country: building and owning telecommunications, electric power, water, roads, the airline, the railways, health care, and education infrastructure and systems. However, lower oil prices in the mid-1980s significantly diminished revenue and forced the government to stop infrastructure expansion.

From 1993 to 1995, government budgeted expenditure decreased by approximately 23%, from $52 billion to around $40 billion (Saudi American Bank, 2003). The Gulf War period caused significant budget deficits, as had the mid to late-1980s, so that by 1995 considerable fiscal imbalances were starting to appear, particularly an increasing debt burden, albeit all domestic. This resulted in the austerity budgets of 1994 and 1995. Table 2-1 shows some important statistical facts about Saudi Arabia.

Table 2-1 Statistic facts about Saudi Arabia

Indicator	Year			
	1997	1998	1999	2000
Population (million)	18.7	19.1	19.6	20.0
Foreign Exchange Rate (SR/$)	3.75	3.75	3.75	3.75
GDP per capita ($/cap)	7,772	6,867	6,633	7,000
GDP ($ billion)	145	131	130	140
Real GDP change %	1.9	1.6	-2.0	2.0
Inflation %	-0.5	-0.2	3.0	2.0
Interest rate %	6.097	6.213	6.432	6.856
Saudi oil price ($/BBL)	18.25	11.50	11.50	11.50
ARAMCO output (MMB/D)	8.36	8.30	8.30	8.30
Oil export revenues ($ billion)	52	33	33	33
Budget deficit ($ billion)	-1.6	-12.0	-12.0	-5.0
Budget deficit (% GDP)	1.1	9.4	9.0	3.4
Total official debt ($ billion)	118.0	130.0	142.0	147.0
Total official debt (% GDP)	81.2	99.3	109.3	104.9
Govt debt to Dom. Banks ($ billion)	28.0	31.0	34.0	37.0
Govt debt to Dom. Banks (% GDP)	19.1	23.4	26.2	26.4
Exports ($ billion)	59.0	37.0	39.0	39.0
Imports ($ billion)	26.0	25.0	25.0	25.0
Trade balance ($ billion)	33.0	12.0	14.0	14.0
Current account balance ($ billion)	0.1	-10.0	-1.7	-6.3
SAMA net foreign assets ($ billion)	57.0	52.0	47.0	44.0

Source: Saudi American Bank, Riyadh, Saudi Arabia, 2001.

In 1998, oil prices dropped severely, reaching a historic low price (approximately $8 a barrel). The government cut spending by 15% from 1997 levels to cope with the revenue decline, but still ran a budget deficit of over $12 billion, close to 9.4% of GDP. However, the oil price recovery beginning in the second quarter of 1999 allowed the government to improve its fiscal performance. It held spending below 1998 levels, and reduced the deficit further, to $9 billion. The 2000 fiscal balance enjoyed a $6.1 billion surplus, the first since 1982. However, the budget slipped again into deficit in 2001.

2.2.2 Macroeconomic variables

One of the objectives of this study is to find whether the macroeconomic variables, such as economic growth, the balance of trade, the unemployment rate, and the inflation rate, could be affected negatively or positively by an increased number of IPOs in the Kingdom. Therefore, reviewing these factors would contribute to achieve this objective.

The question of causation is an important one in finance and economics in general[2]. In the present context, the hypothesis is that more IPOs (and generally the development of the Saudi Stock Market) will cause greater economic growth, improve the balance of trade etc. There is a body of evidence looking at the relationship between economic growth and the development of capital market institutions and stock market in general The general conclusion is that there is a positive effect (Atje and Jovanovic, 1993 and Rousseau and Wachtel, 2000)[3].

This evidence is very difficult to replicate for the Saudi economy. The Saudi economy is largely determined by the success of the oil sector (accounts for more than 88% of the country's exports and nearly 75% of government revenues). Moreover, Chapter Three will show that there have been only 10 IPOs in the last 16 years and the Saudi Stock Market has only 72 listed companies.

There is an alternative hypothesis that causation is the other way around. IPOs are caused by the economy doing well. There is some evidence that IPOs occur more frequently during the stock market booms (Madura, 1998). In this research, it will be possible to provide some

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[2] There is another version of causality – the Granger Causality Test. This version has nothing to do with the discussion of causality that follows. In the Granger Test, if X Granger causes Y, what it means is that X helps in predicting Y (plus other variables in a regression).

[3] It should be mentioned here that Chapter Five will discuss deeply the possible effects of the increased number of IPOs on the macroeconomic factors in general.

partial evidence of this, for Saudi Arabia, by investigating the timing of one case study. It is only partial evidence because of the lack of observations on IPOs in the country. The study of the one company is a case study and therefore can focus on corporate expectations as well as actual results. This will shed further light than a single comparison with IPOs and actual stock market data.

Finally, it can be seen that this question of simultaneous causation is a difficult one to answer for the Saudi economy. Nevertheless, what is possible is to look at the incentives for the creation of IPOs and the beliefs in Saudi about their effects on the economy. This is primarily the route being pursued in this study

2.2.2.1 The gross domestic product (GDP)

Previous researches were capable to find a positive link between the financial system and economic growth. For instance, Atje and Jovanovic (1993) presented a cross-country study of stock markets and economic growth. They find a significant correlation between growth over the period 1980-1988 and the value of stock market trading divided by GDP for 40 countries[4]. Moreover, Edison *et al.* (2002) suggested that well-functioning stock markets are expected to influence growth through increased capital accumulation and also by influencing the efficiency of capital allocation.

The Saudi gross domestic product (GDP), measured at 1999 constant prices, increased sharply from SR 145.0 billion in 1970 to SR 516.3 billion in 1980. The GDP reached 632.9 in 2000. This makes the average annual growth rate of real GDP during 1970 to 2000

[4] More details about this study and other studies investigating the relation between the economic growth and the stock market will be presented deeply in Chapter Five.

around 3.2%. The targeted real growth rate for GDP during the period 2001-2005 was expected 4.6% per year.

However, as will be shown later in this chapter, Saudi Arabia is not always successful in reaching the expected growth rate of GDP. Moreover, the problem with the Saudi GDP that its performance dependents entirely on the price of crude oil since the oil revenue is still the most contributor. Moreover, even though the contribution of the private sector to the GDP increased dramatically in the last three decades, the contribution of the public sector remains very high.

2.2.2.2 The unemployment rate

Generally speaking, a high unemployment rate is considered one of the most crucial problems facing the Kingdom. According to Saudi American Bank (2003), the unemployment rate in 2001 was 15%. The government official figures put the unemployment rate at 8%. However, independent agencies suggest that between 20% to 30% of Saudi males are unemployed. It will be discussed later that the five-year development plan for the years 2000-2004 puts a very strong emphasis on reducing the number of foreign workers and creating new jobs for Saudi nationals. Nonetheless, the development plan is very ambitious, suggesting that 329,000 Saudis can find jobs by replacing 489,000 foreign workers. The absurdity of these numbers can be seen in light of the fact that in 2000 there were 100,000 job applicants; only 25,000 obtained jobs. Economic growth is far too small to create a sufficient number of new jobs for the existing unemployed and at the same time create jobs for 100,000 new entrants into the

labour force[5]. Therefore, the government should increase the necessary training for Saudis by establishing more universities and training centres and employ more restrictive regulations, forcing private sector and the semi government agencies to hire and train more Saudis.

2.2.2.3 The foreign investment

After the crude oil prices reached a historic low price in the late 1990s, the government planners started to realise the need to import more money, experience and technology. Therefore, in April 2000, the Saudi government established the Saudi Arabian General Investment Authority (SAGIA) which is responsible about overseeing investment affairs in the Kingdom, including foreign investments. Moreover, the government issued a new foreign investment law which allows the international companies the possibility of 100% ownership of the projects and permits foreigners to invest in the majority of economic sectors. The government figures in 2002 show that the Kingdom needed $6.7 billion in foreign investment over the next 20 years, divided into the following sectors: $140 billion in infrastructure projects, $116 billion for the electricity sector, $92 billion in petrochemicals, $88 billion for water, $60 billion in telecommunications, $53.4 billion for tourism, $50 billion for the natural gas sector, 28.3 billion for agriculture, and $10.7 billion each for information technology and education. In the near term, the kingdom will look for $20 billion dollars annually in the water, railway, and electricity sectors alone (Central Department of Statistics, 2002).

[5] It will be shown late in this chapter that the Saudi population growth rate is considered one of the highest in the world. Therefore, Saudi economy cannot create sufficient number of new jobs since the number of applicants increases rapidly each year.

Despite the new regulations, despite having one of the largest markets in the region, and having the largest oil reserve in the world, Saudi Arabia is not able until now to import large portion of foreign investments. There are three main factors affecting negatively the rate of international investments. Firstly, the bureaucratic procedures that are needed to open a business in Saudi Arabia. Secondly, the recent terror attacks on foreign residents and interests. Thirdly, as will be shown deeply in next chapter, the Saudi Stock Market is not open completely to the international investors and companies, is inefficient, and has only 72 listed JSCs.

In conclusion, issuing new regulations and establishing new agencies dealing with international investments are not enough to attract foreign money. The Kingdom should work to create a healthy, prosperous, and safe business environment.

2.2.2.4 The inflation rate

The Saudi government officials claim that the cost of living index is one of the lowest levels of inflation in the world. However, on average, the cost of living index increased at an average annual rate of 5.8% during 1970-1990 (Alarfaj, 1996). Table 2-1 shows that in 1999 and 2000, the inflation rate in the country was 3% and 2% respectively.

2.2.2.5 The balance of trade

The Kingdom maintained a favourable balance of trade for the period from 1980 to 1994. The Kingdom's balance of trade has improved noticeably since 1986, when it had a surplus of only SR 3.6 billion. During the Gulf Crisis, the Kingdom's balance of trade recorded a surplus of SR 76.2 billion in 1990 and SR 70.1 billion in 1991. This surplus declined to SR

63.7 million in 1992 and then to SR 53.1 million in 1993. Furthermore, Table 2-1 shows that the Kingdom's balance of trade improved during 2000 and recorded a surplus of SR 52.5 billion.

As Saudi GDP performance, the Saudi balance of trade performance is related strongly to the international price of crude oil. It will be discussed later in this chapter that more than 85% of the Kingdom's exports were crude petroleum and petroleum products.

2.2.2.6 The interest rate

Saudi Arabia Monetary Agency (SAMA) is the responsible body to increase or reduce the interest rate in the Kingdom[6]. Like any other central bank, SAMA uses interest rate as one of its tools to control the money supply. Historically, the interest rate in Saudi Arabia was used either to contain the inflation in the booming period or to stimulate the economy in the recession period. For example, when the Saudi economy was in the booming period of late 1970s and early 1980s, the interest rate in 1984 was 10.75%. Then when the economy started to decline because of the oil prices decrease, the interest rate was also reduced to reach 3.72% in 1993 (Saudi Arabian Monetary Agency, 2003). Finally, after the economic slowdown caused by September 11, 2001 attacks, SAMA had to reduce the interest rate more in the early 2000s to record historical low rate of 1.94% in 2003.

In conclusion, as Chapter Five will discuss, Yu (2002) suggest that increases in interest rates could lead to a decrease in the supply of IPOs, as investment in loans is an alternative asset class to IPOs and private equity. However, Madura (1998) suggested that IPOs tend to occur more frequently when the interest rate is low because low interest rate discourages investors

[6] More information about the SAMA's establishment and responsibilities will be discussed in Chapter Three.

from investing in interest-bearing instruments, such as bonds, therefore, they look for other investment instruments, such as newly listed stocks.

2.3 The contribution of the government to the economy

Until now the Saudi government is considered the major customer and player in the Saudi market. Therefore, to draw a complete picture about the general economic situation in Saudi Arabia, this section presents the role of the Saudi government in stimulating and developing the economy, and the business atmosphere[7].

2.3.1 Government policies and initiatives to strengthen the role of the private sector and the Saudi Stock Market (SSM)

In the recent decade, particularly after the having persistent budget deficit, the government started to realise the need to move the economy from that driven mainly by the government to an economy driven by successful private corporations. Thus, the Kingdom adopts new policies and regulations, which could strengthen the role of the private sector and the Saudi Stock Market (SSM). These policies and regulations are summarised as follows (Ministry of Planning, 2002):

2.3.1.1 Privatisation policies

In general, the government privatisation programme encourages competition, reduces government interference in business, and helps to develop the capital market (Niblock and Murphy, 1993). In Saudi Arabia, the privatisation process constitutes an important part of

[7] Most of the information and economic statistics in this section are based on the reports issued by the Ministry of Planning, Saudi Arabia, which may affect their reliability.

the government's long-term strategy to increase opportunities for the private sector and to enhance the efficiency and competitiveness of the national economy (Ministry of Planning, 2002). A strategic plan for privatisation has been developed in accordance with the Council of Ministers' Resolution No. 60 issued in 1998, which established the general framework of privatisation. The strategy encompasses the following major objectives (Ministry of Planning, 2002):

- Encourage private sector investment and its effective participation in the national economy, as well as increasing its share of GDP
- Increase job opportunities, ensure optimal employment of Saudi citizens, and continually increase per capita income
- Enhance efficiency and competitiveness of the national economy to withstand regional and global competition
- Increase government revenues

In addition, the following implementation steps have been completed during the last Development Plans:

- Approving the restructuring of the electricity sector, leading to the merger of all electricity service companies and electrical projects affiliated to SCECO in one company named the "Saudi Electricity Company"
- A Saudi joint stock utility company has been established in the twin industrial cities of Jubail and Yanbu to operate, maintain, manage, and expand the tasks of infrastructure utilities as part of the privatisation programme
- The Saudi Telecommunications Company was established as a business-oriented

joint stock company providing all telecommunications services previously provided by the Ministry of Post, Telegraph, and Telephones

- Future privatisation programmes will cover the Saudi Railways Organisation, the Saline Water Conversion Corporation, the Saudi Airline, and the Grain Silos and Flour Mills Organisation.

The privatisation policy is considered the most important policy that contributes to boost the performance of the SSM and the number of IPOs in the Kingdom. For example, in January 2003, the Saudi government privatised the Saudi Telecommunication Company (STC). The STC sold 30% of its shares in a public offering valued at approximately U.S. $4 billion. The offering was oversubscribed, as investors offered to buy $9.6 billion worth of shares. The success of the STC IPO process not only demonstrated the markets ability to absorb such a large issue, but also it highlighted the technological capability of the market to handle future IPOs effectively and in a timely manner. Therefore, the huge success of the STC's offerings gave a good indication to the successful private firms that the market is willing to accept them.

Furthermore, the privatisation of the STC increased the numbers of investors in the SSM dramatically. The number of investors in the SSM in 2002, before the Saudi Telecommunication Company was floated, was only 79,800 but at the beginning of 2004 had reached 428,074. This huge increase in number of investors contributed greatly to improving the level of liquidity in the SMM, which makes the stock market more attractive for companies looking for funds.

However, there is fear that privatisation may result only in industries being sold off to a few

already wealthy investors, rather than encouraging mass share ownership (Khairallah, 1995). In addition, privatisation in Saudi Arabia is still nascent, even though many state-owned enterprises are targeted for divestiture (Davis *et al.*, 2000). The government seems ambivalent about the process. For example, the government sold some of its shares in Saudi Telecommunication Company to raise revenue, but still holds 70% of the shares.

2.3.1.2 Supporting small and medium scale enterprises

In Saudi Arabia, small and medium enterprises constitute the bulk of the industrial base and contribute significantly to their exports as well as to their GDP or GNP since the majority of the Saudi enterprises is classified either small or medium. The government has adopted several measures and initiatives to support small and medium scale enterprises. The most important of these measures and initiatives are (Ministry of Planning, 2002):

- Streamlining procedures for establishing small and medium scale enterprises to eliminate associated routine constraints and enhance technical and administrative support for these firms
- Studying the possibility of establishing a special fund, with government and private sector participation, to facilitate access to loans by small and medium scale enterprises

Despite these measures and initiatives, small and medium size enterprises still have several problems such as lack of management skills, poor financial situation, and non-availability of technically trained human resources (These problems will be discussed deeply later in this chapter).

2.3.1.3 Development of non-oil exports

The Kingdom's expected accession to the WTO during the Seventh Development Plan, the establishment of the Gulf Co-operation Council (GCC) Customs Union by 2001 and the Greater Arab Free Trade Area, together with bilateral agreements with various countries (including a possible free trade agreement between the GCC and the European Union) will open up new markets for Saudi non-oil products. To take full advantage of the opportunities that these steps will create, measures will be needed to assist Saudi exporters to overcome hurdles in accessing international markets for non-oil products. Currently, the Saudi Exports Development Centre affiliated with the Council of Chambers of Commerce and Industry, compiles information about foreign markets. The Centre is expected to develop further its marketing channels and expand its range of services to Saudi exporters, while imposing charges on beneficiary companies to cover the costs of providing such services.

Although Saudi Arabia has greatly reduced its dependency on oil in the past three decades, there is still a long way to go. The oil sector accounts for about one-third of total Saudi GDP, and oil still accounts for approximately 90% of export earnings and 75% of budget revenues.The abundant energy resource can be made available to develop domestic enterprise, to attract international investors, and to diversify the Saudi economic base. While some industry remains of an import substitution nature, more of it must be export oriented so as to create much greater scope for export finance business (Jasimuddin, 2001).

2.3.1.4 Improving the regulatory and investment environment

Relevant agencies are currently considering measures to improve the regulatory and investment environment in Saudi Arabia to reach the following objectives (Ministry of Planning, 2002):

- Adjustment of the foreign capital investment law in line with the Kingdom's accession to the WTO, as well as encouragement of foreign investment in the Kingdom
- Establishment of a "one-stop-shop" system whereby services are provided for Saudi and foreign investors, and all administrative procedures required for registering and licensing new investment projects are processed as fast as possible
- Allowing non-Saudi citizens to trade in the SSM. The GCC citizens of Gulf Co-operation Council (GCC) are permitted to participate in the SSM. The participants can own up to 25% of the shares of joint stock companies. Moreover, non-Saudi citizens are allowed to invest in the SSM through special funds established and controlled by local commercial banks.

However, the pervious steps are not enough and the government needs to do more to enhance the regulatory and investment environment. For instance, foreign investors until now suffer from the long procedure that is needed for opening a business in Saudi Arabia. Moreover, as will be shown in Chapter Three and Four, the government needs to improve the regulations dealing with the SSM and the procedure of going public in the Kingdom. Furthermore, in order to increase the SSM liquidity, the Saudi authorities need to open the SSM more to the international investors.

2.3.2 Saudi Arabia's five-year development plans

The accumulation of surpluses in the government budget and the high oil prices and production since the early 1970s enabled the government to achieve its long-term strategic goals by establishing a series of five-year development plans, starting in 1970. The following provide a brief overview of the last six plans regarding their direction, priorities of expenditure on development, and achievements.

2.3.2.1 The direction of the plans

The long-term strategic development objectives were first formulated during the preparation of the First Development Plan in 1970. Over the past three decades, development planning in the Kingdom has acquired its unique characteristic whereby each plan has been tailored to adapt to prevailing conditions and to deal flexibly and efficiently with developments of the coming age, thereby paving the way for the next plan. This concept became the basis for defining the pillars and themes of each individual plan and for ensuring the continuity of development efforts (Ministry of Planning, 2002)

The successive five-year development plans have sustained major long-term strategic goals, reflecting both the important continuity and the nature of the Saudi development process. According to the Ministry of Planning, the major long-term strategic objectives of the five-year development plans are:

1. Maintaining economic growth and social stability
2. Diversifying the economic base and reducing the dependence on crude oil
3. Developing human resources

4. Developing and preserving the physical infrastructure
5. Raising the standard of living and improving the quality of life
6. Expanding the role of the private sector
7. Safeguarding Islamic values and confirming Allah's *Sharia* (holy law)
8. Defending the Faith and the nation; upholding security and social stability; and deepening the values of national loyalty and belonging
9. Enhancing the Kingdom's position within the global economy

Within the context of these objectives, each plan builds sequentially upon the accomplishments of the earlier plans, and laid the foundations for further achievements in the subsequent stage.

The First Development Plan (1970-1975) placed particular emphasis on laying the foundation for the Kingdom's rapid transformation into a more advanced nation by focusing on the provision of infrastructure and basic government services like water supply and electricity generation, along with the expansion of social programmes and the development of Saudi human resources. The plan, however, was not successful in fulfilling certain aspects of the country's development. For instance, the agricultural sector was targeted for an increase of 4.6% annually, but real growth in that sector only reached 3.6%.

The Second Development Plan (1975-1980) focused on economic conditions, as the Kingdom's oil revenues escalated substantially because of the increase in crude oil prices in international markets. The Second Plan focused on maximum possible expansion of transport, electricity, water, and housing infrastructure, conservation of hydrocarbon

resources, encouragement of energy-intensive industries, and export of their high value added products (Ministry of Planning, 2002).

This direction was supported by establishing the Royal Commission for Jubail and Yanbu with the aim of providing infrastructure necessary for hydrocarbon industries[8]. On the other hand, the Second Development plan placed particular emphasis on the development of financial and administrative policies and regulations, in conformity with development requirements and the progress of the national economy, as well as facilitating cooperation between the public and private sectors in order to realise higher growth rates. The growth rate in the oil sector, at 4.9% per annum, fell short of the target of 9.7%. The overall GDP growth rate was also slightly lower at 9.3%, compared to the target of 10.2%.

The Third Development Plan (1980-1985) coincided with a substantial expansion in the national economy and increased oil revenues that made the Kingdom a great financial power through its economic role as the largest exporter of oil in the world. Therefore, the focus at this stage was on reaching structural change in the national economy by defining oil and gas production levels to maintain national resources, completing the infrastructure projects, and continuing to build hydrocarbon industries. At the end of the plan period, the oil sector contribution to GDP fell by 14.6%, offsetting the positive growth of 5.1% in the non-oil sector. Therefore, the overall growth rate also turned negative by 5.8% per annum during the plan period.

[8]The Royal Commission for Jubail and Yanbu (RCJY) was established as an autonomous organisation of the Saudi Government. The mandate of the RCJY is to implement the physical and social infrastructure required for the development of Jubail and Yanbu areas as industrial cities.

The Fourth Development Plan (1985-1990) adopted a new model in terms of planning methodology and focus. Methodologically, the plan shifted from a central planning and projects-based approach towards the programme planning method that would ensure greater flexibility for government agencies (Ministry of Planning, 2002). The plan focused on the operation and maintenance of projects, diversification of the production base, and restructuring the national economy, enabling the private sector to play a substantial role in the economic development process.

In ***the Fifth Development Plan (1990-1995),*** the government encouraged the private sector to play a greater developmental role and to increase its participation in some areas where the government traditionally provided services, such as some public utilities, the health sector, the communications sector, and the transport sector. Moreover, the Fifth Plan focused on crucial development initiatives such as improving the technical base in many economic sectors by using modern technologies. Unfortunately, implementation of the Fifth Plan was adversely affected by the Gulf War (1991), which necessitated some adjustments in the priorities of government expenditure, which in turn, affected private sector investment.

The Sixth Development Plan (1995-2000) was prepared under the extraordinary domestic and global conditions that prevailed in the aftermath of the Second Gulf War, in addition to the adverse developments that have taken place in the world oil market in recent years. However, the Sixth Plan tried to achieve its objectives by boosting the private sector's role in diversifying the economic base and reducing dependence on oil revenues. Consequently, the Sixth Development Plan stressed the need to realise the three objectives. These are development of human resources, realisation of economic efficiency in both the public and

private sectors, and enhancing the role of the private sector and encouraging it to invest (Ministry of Planning, 2002).

2.3.2.2 Priorities of expenditure on development

Table 2-2 illustrates the changing priorities and areas of focus over the first five development plans, 1970 to 1994. Table 2-2 shows the attention given by the successive development plans to the expenditure of development agencies, and it can be seen from Table 2-2 that:

- Average expenditure on infrastructure development during the First and Second Development Plans reached 41.4% and 49.3% respectively of the total actual expenditure of the development agencies, exceeding average expenditure on the development of economic, human, social and health resources, thus establishing an integrated base of infrastructure needed to accelerate socio-economic development.
- During the Third Development Plan, 41.1% of total actual expenditure of development agencies was directed towards the completion of infrastructure related to the producing sectors, while expenditure on economic resources development reached 30.7%.
- During the Fourth and Fifth Development Plans, emphasis was placed on enhancing the capabilities of the Saudi labour force and improving standards of education, health and social services. Thus, expenditure on human resources development accounted for 33% and 48%, while social and health development expenditure reached 17.7% and 20% respectively of total actual expenditure during both plans.

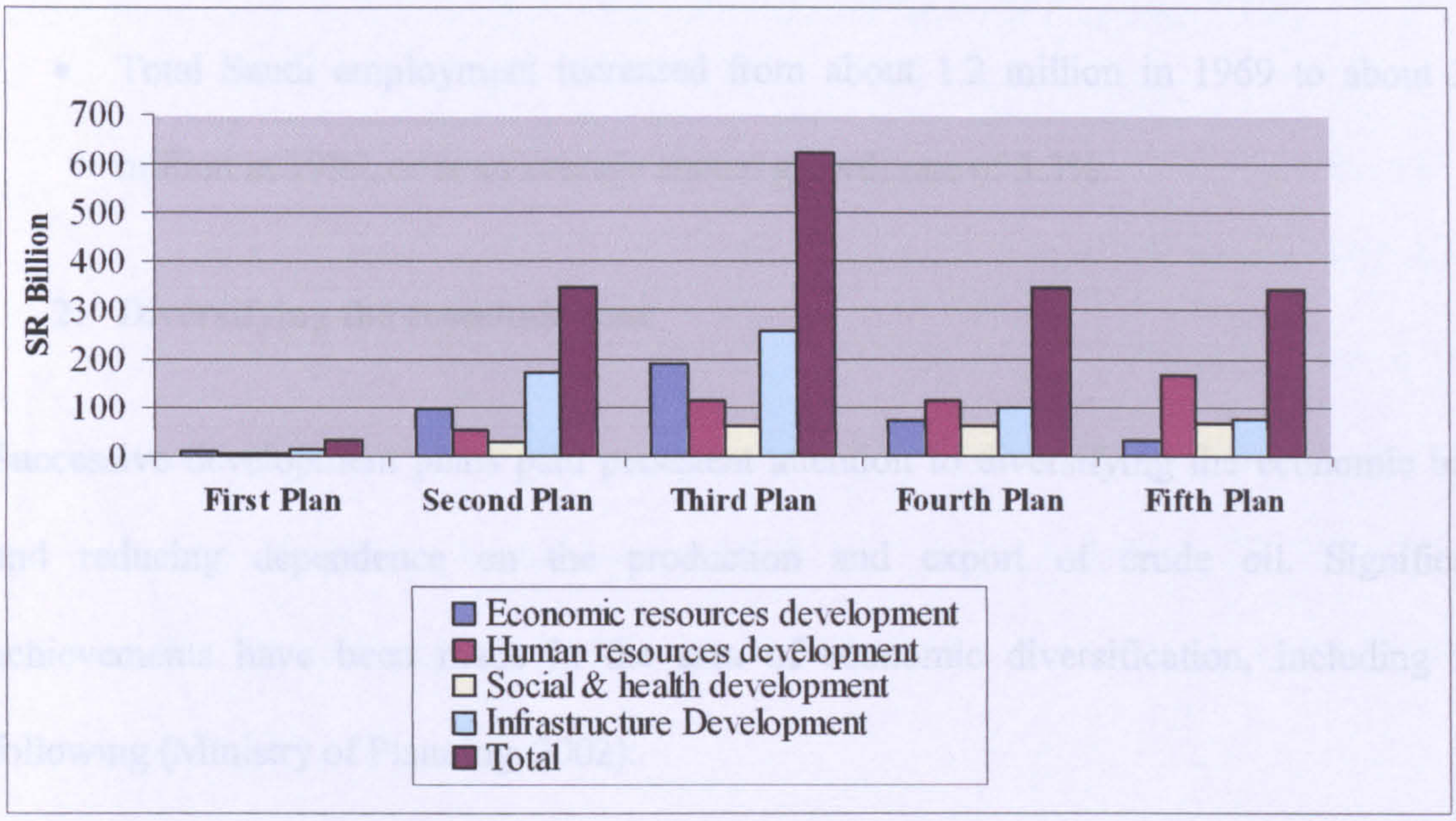
- Expenditure on infrastructure continued over the five plans in response to the growth in demand resulting from population growth and socio-economic development. Thus, expenditure on the completion of infrastructure during the Fourth and Fifth Plans averaged 25.5 % of total actual expenditure.
- There was a steady increase in the share of expenditure on human resources development over the last three plans, which rose from 18.4% of total actual expenditure on development agencies during the Third Plan to 33% during the Fourth Plan and 48% in the Fifth Plan, thereby reflecting the increasing importance of human resources development.

Table 2-2 Actual expenditure by development agencies during the five year development plans 1970-1994

Expenditure on	First Plan		Second Plan		Third Plan		Fourth Plan		Fifth Plan	
	SR Billion	(%)	SR Billion	(%)	SR Billion	(%)	SR Billion	(%)	SR Billion	(%)
Economic resources Development	9.5	27.7	97.3	28.0	192.2	30.7	71.2	20.4	34.1	10.0
Human resources development	7.0	20.6	51.0	14.7	115.0	18.4	115.1	33.0	164.6	48.0
Social & health development	3.5	10.3	27.6	8.0	61.2	9.8	61.9	17.7	68.0	20.0
Infrastructure Development	14.1	41.4	171.3	49.3	256.8	41.1	100.7	28.9	74.2	22.0
Total	**34.1**	**100.0**	**347.2**	**100.0**	**625.2**	**100.0**	**348.9**	**100.0**	**340.9**	**100.0**

Source: Saudi Arabia Monetary Agency (SAMA), Riyadh, Saudi Arabia, 2002.

Figure 2-1 Expenditure by development agencies in plans (1970-1994)



2.3.2.3 Socio-economic achievements

These successive development plans contributed to each of the following socio-economic achievements (Ministry of Planning, 2002):

1. **Economic growth and social stability**

The successive development plans help to achieve the following (Ministry of Planning, 2002):

- Real GDP growth averaging 4.34% per year between 1969 and 1999. During the same period, the annual rate of growth in the non-oil sectors averaged 5.22 %.

- The period 1970-1999 was characterised by a gradual decline in inflation (measured by the consumer price index), whereas average inflation for the period 1984-1995, did not exceed 2%.
- Total Saudi employment increased from about 1.2 million in 1969 to about 3.2 million in 1999, or at an average annual growth rate of 3.3%.

2. Diversifying the economic base

Successive development plans paid persistent attention to diversifying the economic base and reducing dependence on the production and export of crude oil. Significant achievements have been made in the area of economic diversification, including the following (Ministry of Planning, 2002):

- Non-oil GDP increased more than fivefold during the period 1969-1999. The percentage contribution of non-oil sectors to GDP increased from 52% to 68.4%, during the same period, at constant 1994 prices.
- The value of non-oil merchandise exports increased from almost nothing in 1969 to about SR 397 billion in 1999 representing 18.6% of total merchandise exports.
- The contribution of non-oil revenues to total government revenues increased from 11.5% in 1970 to over 24% in 1996 and to 34.3% in 1999.
- The value added of manufacturing industries grew at an average annual rate of 7.4% over the period 1970-1999 and the contribution of this sector to GDP increased from 2.1% to 5% during the same period.
- The value of agricultural production increased from SR 4.4 billion in 1970 to SR 35.8 billion in 1999.

3. Strengthening the role of the private sector

The growing maturity of the private sector and its resilience to declining government expenditure are evident in the following indicators (Ministry of Planning, 2002):

- Private sector production increased by an average annual rate of 5.6% over the period 1969-1999, surpassing the 4.3% average annual growth rate of GDP during the same period. The private sector's contribution to GDP and to non-oil GDP amounted to 50.6% and 74% respectively in 1999, at constant 1994 prices.
- Annual private investment increased from SR 1 billion in 1970 to SR 78.6 billion in 1999, thus bringing the contribution of the private sector to fixed capital formation to 67.3%.

4. Development and maintenance of infrastructure

The present infrastructure network in the Kingdom represents one of the most prominent achievements of development planning over the last thirty years. The large-scale construction of infrastructure carried out in the last decades has supported the rapid economic and social development of the Kingdom. However, the high demand resulting from a rapidly growing population has increased the need to expand the Kingdom's physical infrastructure. The following indicators illustrate the quantitative changes in this regard (Ministry of Planning, 2002):

- The paved road network grew from 8,000 kilometres in 1969 to about 45,400 kilometres in 1999. The Kingdom now has 25 modern airports, including three international airports.

- Electricity generating capacity increased from 344 megawatts in 1969 to 20,266 megawatts in 1998 at an average annual growth rate of 15.7%.
- The capacity of desalination plants increased from 19,400 cubic metres per day in 1969 to about 2.2 million cubic metres per day in 1999, at an average annual growth rate of over 16.7%.

5. Development of human resources

The Kingdom's successive plans have given greater attention to human resources development through continuous support of primary, intermediate, secondary and higher education, as well as of technical education, vocational training, and pre-service and in-service training. The result has been a great increase in the productive employment of Saudi citizens, and a steady upgrading of the skill levels and occupational achievements of the Saudi labour force. The following indicators reflect the major achievements in the field of human resources development (Ministry of Planning, 2002):

- Graduates (male and female) at secondary level increased from 3,745 in 1969 to more than 165,000 in 1999. Graduates of technical education and vocational training increased from 417 in 1969 to 13,832 in 1999.
- Enrolment in all educational institutions increased from around 600,000 in 1969 to about 4,748,000 students (male and female) in 1999.

Despite the biggest expenditure priorities in the five year development plan going to develop the human resource and to create and maintain infrastructure, the country still has not fully reached these goals. Because of the shortage of technical skills among

Saudis and access to cheap foreign labour, the Kingdom still depends greatly on foreign workers. For example, construction workers have been almost 100% foreigners up to the present time.

According to official estimates, the share of foreigners within total (civilian) employment rose from 20% in 1974 to 43% in 1979, 59% in 1985, and 61% of total employment in 1994. Subsequently, there was a gradual decline to 52% in 2001. In absolute terms, the number of foreigners working in Saudi Arabia rose rapidly from 314,000 in 1974 to 1.5 million in 1980, and 3.9 million in 1995, and peaked at over 4 million in 1998. In 2002, the official estimates are 4 million employed foreigners and 3 million employed Saudis. But estimates by independent agencies suggest that there is an even greater Saudi dependence on foreign labour: only 2 million Saudis are in the labour force as against 5.5 million foreigners. These foreign labourers send home $16 billion a year to their families in India, Pakistan, Egypt, Jordan, and elsewhere, a massive drain of resources.

Additionally, some parts of the county, especially small- and medium-sized cities and urban areas, suffer from a shortage of hospitals and schools, and an excess of low-quality roads. Thus, the government has to give greater attention to these cities by improving the quality of the infrastructure and encouraging the private sector to invest in them.

Finally, the country's economic statistics may come as a shock. Population growth (about 4% per year) has exceeded Gross Domestic Product (GDP) growth for several decades. The result has been a decline in per capita GDP from more than U.S. $15,000 in 1980 to about U.S. $9,000 in 2003 (adjusted for inflation). Furthermore, there is up to 20-30% of the population falls below the poverty line (looney, 2004).

2.4 The contribution of the private sector to the Saudi economy

2.4.1 General background

The role and effect of the Saudi private sector is increasing gradually. Table 2-3 shows that the number of operating factories increased from 199 in 1970 to 3,123 in 1999, while the number of companies in the private sector increased from 923 in 1970 to 9,302 in 1999. The share of the private sector reached 50.6% of GDP and 74% of non-oil GDP by the end of 1999. Total employment in the sector increased from about 1.83 million in 1970 to 6.16 million by the end of 1999, and private sector employment accounted for 85.9% of total employment at the end of 1999.

Industrial investment increased from SR 2.8 billion in 1970 to SR 232 billion in 1999. Therefore, the value added of the manufacturing industries sector increased during this period by a real average annual growth rate of 15%, more than doubling its contribution to non-oil GDP.

Table 2-3 Main indicators of the private sector's role in the national economy

Indicator	Years	
	1970	1999
Number of operating factories	199	3,123
Number of private sector companies	923	9,302
Contribution to GDP	33.3%	50.6%
Contribution to non-oil GDP	67.9%	74.0%
Contribution to fixed gross capital formation	47.3%	67.3%
Employment in the private sector (million)	1.83	6.16
Private sector employment as % of total employment	N/A	85.9

Source: Ministry of Planning, Riyadh, Saudi Arabia, 2002

Moreover, in 1980 Saudi Arabia had only 730 industrial plants with a total invested capital

of $6.3 billion. At year-end 2000, the number of plants had grown to 4,836 with a total invested capital of $71.9 billion. The government's direct and indirect subsidies have substantially contributed to accelerating the growth of the private sector during the early stages of the development process. However, the private sector is now able to operate without government support and subsidies. A survey of the private sector shows that government financial support constitutes less than 5% of total private investment in 1998. In addition, the private sector's implementation of government contracts accounted for only 13% of its total revenues in 1998, compared with more than one third of its total revenues ten years ago. The private sector currently sells over 80% of its output in the domestic market to non-government agencies, thus reducing its reliance on government subsidies, while at the same time acquiring the ability to adjust to variations in the level of government expenditure in a flexible and efficient manner.

2.4.2 Challenges facing private sector

Like other countries, Saudi Arabia, and particularly its private sector, faces some challenges. Some researchers argue theoretically that private companies can solve most of the problems they have by going public because it would enhance the company's ability to grow more, find new source of funds, be more competitive, motivate management and employees, improve credit rating, enhance company image, and solve the problem of lack of family succession and control[9].

The major challenges facing Saudi private sectors are summarised as follows (Ministry of Planning, 2002):

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[9] Chapter Five in this study will show deeply that the advantages and benefits of a stock market flotation are manifold.

2.4.2.1 Generation shift

The majority of Saudi firms is family-owned firms (Alarfaj, 1996). These firms are facing now a generation shift. When family members work together, emotions may interfere with business decisions. Conflicts may arise as relatives see the business from different perspectives. Therefore, one of the biggest challenges a privately owned business faces is survival beyond its original founder. Statistics show that closely held businesses, particularly those that are family owned, face an extremely difficult task in surviving to the second generation. In fact, less than one-third of all family businesses makes it to the second generation and less than 15% of those makes it to the third generation (Davis *et al.*, 2000). The primary reasons for this low survival rate are, firstly, the failure to develop and effectively plan for the transfer of ownership and management of the closely held family business. Secondly, the next generation has a lot different life style than the business founder and entrepreneur. They do not share the same drive and commitment that parents needed to build the business from scratch. They go to the good schools, get a taste of the good life and generally do not share the passion of the business founder. To keep the business running and performing well, the original owners must take legal steps to ensure continued business activity when they decide it is time for them to retire.

One of the solutions is by going public since the situation of being JSC would grant the companies several advantages. As will be discussed in Chapter Five, the most important of those advantages here are, firstly, the companies would be run by very professional management team. Secondly, going public would give the company a separate identity

than the identity of the business owners (separate the life of original owners from the life of that companies).

2.4.2.2 Constraints of finance

Many businesses in Saudi Arabia face difficulties in finding finance sources willing to fund their current and future projects. The main reasons behind this constraint are that, firstly, many firms, especially small and medium enterprises, cannot meet the requirements for loans and other types of credit from banks and government specialised credit institutions.

Secondly, there are few numbers of commercial and investment banks in the country. The reason behind the low bank numbers in the Kingdom is that the government has restrictive regulations for rewarding licences to new banks. However, Saudi Arabia, in 2003, made an important financial and political move when it announced it would grant a full branch banking licence to BNP Paribas, JP Morgan and Deutsche Bank.

Thirdly, there are no non-bank financial intermediaries. The government needs to allow non-bank financial intermediaries to provide a range of financial services that are limited until now to the banks only. This move, if happened, would increase share and securities trading and encourage more public flotation.

Finally, because of the little finance sources in Saudi Arabia, private firms can obtain the fund needed by seeking public equity. Röell (1996) suggested that, in the longer term, the issue of public equity facilitate the raising of new finance in several conceptually distinct ways. These ways are:

1. The equity base is strengthened and leverage is reduced, therefore, mitigating in the future the debt overhang and other agency problems.
2. Sufficient liquidity in the equity market can be a prerequisite for the raising of further capital.
3. Competition among supplier of finance. As it will be discussed in Chapter Five, going public could enable companies to widen the sources of their bank loans and to negotiate better terms for loans

2.4.2.3 Saudisation and employment

As has been discussed previously in this chapter, a high unemployment rate is considered one of the most crucial problems facing the Kingdom. The unemployment rate is believed to be between 20% and 30%. Recently, the Saudi government has begun relying heavily on the private sector to provide job opportunities for the steadily growing number of Saudi new entrants to the labour market.

Despite the fact that the private sector provided about 473,500 jobs for Saudis during the Sixth Development Plan compared to about 154,700 jobs provided by the government sector, the number of Saudi nationals still constitutes a modest percentage of total private sector employment. Studies prepared by the Manpower Council indicate that the majority of foreign workers in the Kingdom work in establishments employing less than 20 workers. At the same time, the share of new private sector jobs taken by Saudis is rising.

2.4.2.4 International trade liberalisation and globalisation

The Kingdom's expected accession to the WTO will bring important advantages to the

Saudi private sector by overcoming constraints on the development of non-oil exports, particularly petrochemicals, and by enforcing action against dumping. Moreover, the stability and transparency of rules and regulations applicable to both indigenous and foreign firms alike will greatly enhance the environment for attracting foreign direct investment and expanding joint ventures. On the other hand, the private sector's activities will face several challenges such as increased competition in most of sectors, and a rationalisation of subsidies.

The Saudi government was hoping to join the WTO in 2002, however, until now the Kingdom has not become a member. Senior Saudi industrial and commercial officials admit that WTO membership will require changes to the Kingdom's economy and trade practices and regulations, a process that is by no means guaranteed to go smoothly. They think the Kingdom must do more to present detailed offers on market access. Furthermore, implementation of wide-ranging reforms is still expected to be a long process, as many of the reforms required for WTO membership, including measures such as easing restrictive practices in the banking sector, are likely to be strongly resisted by vested interests in the Kingdom.

Finally, one of the ways that Saudi private companies can overcome the problem of libralisation and benefit from the new situation is by making IPO (Gulf Base, 2002). IPO would strengthen companies capital structure, provides them with greater brand recognition and enhances thier ability to attract and retain talented employees. Moreover, the IPO gives companies the financial capacity and flexibility they need to scale thier business and take advantage of the outstanding opportunities ahead (Gulf Base, 2002)

2.4.2.5 Constraints facing small and medium scale enterprises

Small and medium scale enterprises play an essential role in providing job opportunities for Saudis, and in creating greater diversification, which increases productivity and flexibility for the national economy. However, beside the difficulties discussed above, these enterprises face more obstacles preventing them doing their job in motivating the economy. These barriers are (Ministry of Planning, 2003):

- ***Economic feasibility studies:*** Most small and medium scale enterprises start their business without conducting appropriate feasibility studies. Most of these firms do not conduct such studies from a lack of experience and from ignorance. Feasibility studies could help these enterprises from exposing themselves to various risks which could be decreased by improving the quality of economic feasibility studies.
- ***Productivity and management efficiency:*** Usually small firms have lower organisational and management standards because of the lack of technically skilled personnel and management experience, together with poor accounting and record keeping standards, as well as inadequate technical capacity for market research and promotional activities. In order to improve their conditions, an adequate mechanism for rendering assistance, training programmes, and consultation for these establishments will be needed.

2.4.3 The classification of companies in the private sector

The Companies Act classifies companies operating in the Kingdom as follows (Ministry of Commerce, 1985):

- ***Joint stock companies***: the capital of a joint stock company shall be divided into negotiable shares of equal value. The number thereof shall be responsible to the extent of the value of their shares, and their number shall not be less than five (Article 48).
- ***Limited liability partnerships***: consists of two categories of partners, one being at least one general partner who is responsible to the extent of his entire fortune for the partnership debts, and the other being at least one limited partner who is responsible for the partnership to the extent of their interest in the capital (Article 36).
- ***Joint liability partnerships:*** a general partnership is an association of two or more persons who assume joint liability, to the extent of their entire fortune, for the partnership debts (Article 16).
- ***Mixed liability partnerships***: a mixed liability partnership consists of two or more partners who are responsible for the debts of the partnership to the extent of their interest in the capital, and in which the number of partners does not exceed fifty (Article 157).
- ***Mixed liability partnerships by shares***: a mixed liability partnership by shares is a partnership consisting of two categories of partners. One being at least one general partner who is responsible to the extent of their entire fortune for the debts of the partnership, and the other includes at least four shareholders who are responsible for the debts of the partnership only to the extent of their shares in the capital (Article 149).
- ***Joint venture***: a joint venture is a company that does not disclose its venture to others, does not have any legal entity, and does not have any kind of publication

formalities (Article 40).

Table 2-4 provides some statistics about companies operating in the Kingdom. It is clear from Table 2-4 that the great majority of companies, 64.47%, in Saudi Arabia are limited liability partnerships. Moreover, the total number of joint stock companies in 2000 was only 116 companies, comprising just 1.14% of the total number of the firms in the country and 46.20% of the total capital of companies. This unique businesses' structure raise the essential question of why Saudi Arabia does not have a great number of JSCs[10].

Table 2-4 Companies operating in Saudi Arabia in 2000

Nature of companies	No.	%	Capital (SR)	%
Mixed Liability Partnerships:	**1,012**	**9.96**	**1,840,641,697**	**1.17**
Saudi	1,001	9.85	1,803,233697	1.14
GCC Countries	1	0.01	300,000	0.00
Joint venture	8	0.08	21,941,00	0.01
Non-Saudi	2	0.02	15,177,000	0.01
Mixed Liability partnerships by shares:	**1**	**0.01**	**500,000**	**0.00**
Saudi	1	0.01	500,000	0.00
Joint Liability Partnerships:	**2,483**	**24.40**	**3,831,051,649**	**2.43**
Saudi	2,446	24.10	3,797,960,949	2.40
GCC Countries	17	0.17	12,356,600	0.01
Joint venture	19	0.19	15,734,100	0.01
Non-Saudi	1	0.01	5,000,000	0.00
Limited Liability Partnership:	**6,553**	**64.50**	**79,325,067,709**	**50.20**
Saudi	5,239	51.50	47,717,369,428	30.20
GCC countries	100	0.98	1,020,893,000	0.65
Joint Venture	1,189	11.70	30,467,599,281	19.30
Non-Saudi	25	0.25	119,206,000	0.08
Joint stock companies:	**116**	**1.14**	**72,982,743,176**	**46.20**
Saudi	116	1.14	72,982,743,176	46.20
Total number of companies:	**10,165**	**100.00**	**157,980,004,231**	**100.00**
Saudi	8,803	86.60	126,301,787,250	80.00
GCC countries	118	1.16	1,033,549,600	0.65
Joint venture	1,216	12.00	30,505,274,381	19.30
Non-Saudi	28	0.28	139,383,000	0.09

Source: Ministry of Commerce, Riyadh, Saudi Arabia, 2002

[10] To the best of the researcher's knowledge, there is no study tried to find empirically the reasons behind the low numbers of JSCs in the Kingdom. However, one of the main aims of this research is to investigate this issue empirically.

2.5 Competition in Saudi Arabia

This chapter has shown that one of the difficulties faces the Saudi private sector is the international trade liberalisation and globalisation which leads to severe competition. Reviewing the competition level in the Kingdom is very fundamental since, firstly, it is believed that one of the ways for Saudi firms to be more competitive is by going public. The position of JSC could make companies more respected from customers and lenders, more recognisable and better known, and more preferable by well-qualified personal. Therefore, the likelihood of an IPO should be positively correlated with the level of competition.

Secondly, reviewing the competition level in the country is needed because the researcher in this study tries to answer the research questions by investigating a real IPO case (single case study). Thus, the company performance pre- and post-IPO and the reason behind the going public decision could be influenced by the competition intensity in the company's industry in particular and in the Saudi market in general.

Finally, another objective of this study is to find if the decision to go public is particularly correlated with a specific group of companies. One of the groups that is believed to be more likely to go public is *"companies working in very competitive industries"*. Therefore, the following subsections present information about companies that are competitive or uncompetitive in the country and also about the competitive advantages of Saudi Arabia using Porter's model.

2.5.1 Competitive advantages of the Saudi nation

Companies operating in the Kingdom can be classified into three groups (Mudani, 1987;

Saudi Export Development Centre, 1994; Saudi Consulting House, 1994; Al-Motawa, 1994; Alarfaj, 1996). The first classification consists of successful companies in both domestic and international markets. The second group contains companies that are able to compete locally but are either non-competitive in international markets or do not try to operate outside the country. The last group includes firms that are not competitive either in the domestic or international markets.

2.5.1.1 Domestically and internationally competitive companies

Saudi Arabia has a competitive advantage in petrochemicals and energy and a few companies are internationally competitive (Alarfaj, 1996). ARAMCO, a state company, and SABIC, 70% of its shares held by the government, are responsible for more than the two-thirds of the Kingdom's total exports. Table 2-5 shows that 88% of the Kingdom's exports in 1997 were crude petroleum and petroleum products.

Table 2-5 Merchandise exports by main sectors in millions SR

Main Sectors	1997		1987		1970	
	Value	%	Value	%	Value	%
Crude Petroleum	163,016	71.67%	55,171	63.50%	9,080	83.25%
Petroleum Products	36,753	16.16%	21,326	24.55%	1,799	16.49%
Other	27,674	12.17%	10,383	11.95%	28	0.26%
Total	**227,443**	**100.00%**	**86,880**	**100.00%**	**10,907**	**100.00%**

Source: Centre Department of Statistic, Riyadh, Saudi Arabia, 2002

Exports of other merchandise, such as chemicals, food, and agricultural goods, represented 0.26% of total exports in 1970. However, the percentage of other exports is improving, reaching 13% in 1997.

The two above-named companies are good examples of success due to commitment to sustainable upgrading and improvement (Alarfaj, 1996). ARAMCO and SABIC are putting a lot of money into physical facilities, process technology, global service networks, and research and development programmes. For example, SABIC's R. and D. budget in 2001 was SR 270 million (SABIC, 2002). Moreover, SABIC is putting a great deal of effort into the expansion of the chemical industry by using measures such as research and publishing feasibility studies for several projects.

2.5.1.2 Domestically competitive companies

Companies in this group can be identified here based on the competitive advantages they have into three subgroups (Alarfaj, 1996).

- **Nationally-made as a competitive advantage**

Governmental purchases, subsidies, protection on domestically produced goods, and interest free loans are important factors enhancing many firms' profitability. For instance, the Saudi government imposes a 12% tariff on imports that are competitive to local products. Moreover, many companies in the industrial and agricultural sectors receive governmental interest free loans.

However, a great number of companies in this category are having some difficulties in producing cheap and high quality goods. This situation makes their products uncompetitive relative to the products of other countries, such as Malaysia, Taiwan, and the USA (Mudani, 1987).

Because of the huge drop in oil prices in the 1980s and 1990s, and the second Gulf War, the Saudi government significantly reduced its subsidies to the private sector. The change of policy made companies in this subgroup bankrupt or operate with low profit margins. For example, approximately 300 companies ceased trading in 1983 alone (Economical Gulf, 1984). Al-Olyan (1985) says, *"the large number of bankruptcies and businesses leaving during the recession of 1983 indicated that there were many defects in planning and management"*

Another example is the contract sector, which depends heavily on the government. The demand in this sector decreased to approximately 70-80% because of the decline in government expenditure (Saudi Chambers Council, 1987; Al-Moalmy, 1991). Consequently, the majority of firms in this sector are unable to operate due to high supply and low demand.

- **Closeness to customers as a competitive advantage**

The success of companies in this subcategory comes from proximity to their local customers. These companies focus on producing goods and services meeting only local needs. Agents of foreign firms and many small to medium firms working in industries such as retailing, farming, maintenance, and construction, etc. belong to this group (Alarfaj, 1996).

Many companies, especially agents of well-known international companies (legally unable to sell outside the local market), make significant profits. Nevertheless, all companies, in general, compete harshly with each other leading to lower sales and profits.

- **Differentiation as a competitive advantage**

This final subcategory represents companies providing products and services that overseas competitors cannot duplicate because they are differentiated (Alarfaj, 1996). These companies produce products and provide services which require advanced skills and abilities, such as professional and highly trained employees, internal technical capability, and close relationships with clients. The majority of these companies are family businesses which inherited such skills (Alarfaj, 1996). Interestingly, their capability of competing internationally is high, but they are unwilling to expand their businesses outside the Kingdom because of satisfaction with the status quo, or unable to do so because of a lack of information and resources (Saudi Chambers Council, 1989; Al-Zamil, 1995). Based on the Saudi Chambers Council (1989, p.74): *"There are many firms with very competitive products locally and even outside the Saudi market, however, they are not able to maximize their profits due to poor management in general and marketing managers in particular"*

2.5.1.3 Unsuccessful companies

Several businesses got out from the market because they were ineffective and/or inefficient (Habeb and Abdeen, 1987; Al-Motawa, 1994). However, many companies (mostly new and small) do not live long enough to pass the introductory stage of their life cycle because of harsh and destructive competition from local and overseas companies (Riyadh Chamber of Commerce and Industry, 1994; Al-Hejelan, 1995). On the other hand, the lack of managerial and labour skills and financial supplies forced many companies to go bankrupt even when they were operating in a less competitive environment (Saudi Chambers Council, 1987; Riyadh Chamber of Commerce and Industry, 1994).

Alarfaj (1996) argues that since the Saudi market welcomes any other countries' products, the very low percentage of private sector exports (4% in 1990) indicates that, with some exceptions, private sector companies are uncompetitive in the local and international markets. This assumption could be supported by the large amount of money spent on imports. Although one may argue that this could be a result of increasing population growth, given the fact that many firms complain about working at less than their production capacity (Riyadh Chamber of Commerce and Industry, 1994).

2.5.2 Competitive advantages of Saudi Arabia using Porter's model

Porter (1990) identified four determinants of national competitive advantage. These determinants are:

- ***Factor conditions of a nation.*** The nation's position in factors of production, such as the infrastructure or skilled labour, necessary to compete in a given industry.
- ***The demand conditions.*** The nature of home demand for the industry's products and services.
- ***Related and supporting industries.*** The presence or absence in the nation of supplier industries and related industries that are internationally competitive.
- ***Firm strategy, structure, and rivalry***. The conditions in the nation governing how firms are established, organised, managed, and the nature of local rivalry.

Porter (1990) finds that nations are most likely to succeed in industries or industry segments where the national "diamond" is the most favourable and that the "diamond" is a mutually

reinforcing system[11]. The effect of one determinant is contingent on the state of others. Favourable demand conditions, for example, will not lead to competitive advantage unless the state of rivalry is sufficient to cause firms to respond to them.

Porter suggested that two additional variables can influence the national system in important ways. These are chance and government. Chance events are developments outside the control of firms (and usually the nation's government), such as new inventions, breakthroughs in basic technologies, and wars. Moreover, Porter (1990) believes that the government, at all levels, can play an important role in improving or detracting from the national advantage. Its policies affect every determinant. For example, antitrust policy affects domestic rivalry; regulation can alter home demand conditions and investment in education can change factor conditions.

Finally, Porter says, *"the basic unit of analysis for understanding national advantage is the industry. Nations succeed not in isolated industries, however, but in clusters of industries connected through vertical and horizontal relationship. A nation's economy contains a mix of clusters, whose makeup and sources of competitive advantage (or disadvantage) reflect the state of the economy's development."*

2.5.2.1 Factor conditions

The Kingdom is the leading country in the world in oil reserves, production, and exports. Its proven oil reserves by the end of 1998 amounted to approximately 261.1 billion barrels, constituting 26% of the world's total oil reserves and the Kingdom's oil production reached 8.30 million barrels per day in 1998, or 13% of world production (Ministry of Petroleum

[11] Porter used diamond shaped diagram as the basis of framework to illustrate the determinants of national advantage.

and Mineral Reserves, 2002). By 2000, the proven natural gas reserves in the Kingdom amounted to 219 trillion cubic feet, constituting 4% of world reserves.

Table 2-6 Crude oil and gas statistics in Saudi Arabia

Material	Year			
	1985	1990	1995	2000
Crude oil reserves (million barrels)	169,183	260,342	261,450	262,766
Gas reserves (trillion cubic feet)	N/A	184,548	195,917	222,450
Crude oil production (million barrels)	1,142.80	2,340.50	2,928.50	2,962.60
Gas production (billion cubic feet)	N/A	1,301,955	1,547,965	1,889,658

Source: Ministry of Petroleum and Mineral Resources, Riyadh, Saudi Arabia, 2002

The Kingdom has an excellent infrastructure which contributes obviously to the booming business atmosphere in the country. Roads, airports, railroads, health services, financial services, postal services, and telecommunication have all been modernised. However, all infrastructure services are owned, controlled and monopolised by the government. Some regulations controlling these services are characterised by rigidity and bureaucracy, making policy execution, to some extent, difficult and time consuming (Saudi Consulting House, 1994).

As has been discussed, the Kingdom of Saudi Arabia comprises about four-fifths of the Arabian Peninsula. The size of the country is 2,250,000 square kilometres (868,730 square miles), which is slightly more than one-fifth the size of the USA. Despite this large size, most of the land is not suitable for arable farming (El-Naiem, 1980). The climate is harsh and dry with great extremes of temperature and most areas have a rainfall of less than 4 inches a year (Alarfaj, 1996).

There are no foreign exchange controls – capital moves freely in and out; there are no personal income taxes; there are ten-year tax holidays for manufacturing projects; raw

materials and components can be imported duty-free and the protection of private ownership is established (Jasimuddin, 2001). Moreover, the Saudi government adopts strong antitrust legislation; low entry barriers to business; and development of common standards that promote exports (Jasimuddin, 2001).

From the beginning of development, the planners recognised shortages in the labour force. Consequently, a few million foreign workers were 'imported,' most of them from India, Bangladesh, Egypt, and the Philippines. The unsustainability of the non-Saudi workers was one of the problem that private sector had (Saudi Chambers Council, 1989, and Al-Motawa, 1994).

As previously stated in this chapter, the Saudi work force has increased gradually because of population growth, rapid expansion in education, and new regulations. However, most companies favour foreign workers who are more qualified and much cheaper than Saudi workers. As a result, only 6.5% of the total labour force works in the private sector (Saudi Chambers Council, 1989; Shaker, 1995). In addition, trade unions are forbidden in the country and there are no regulations setting a minimum wage.

In general, the Kingdom is spending little money on research and development (R. and D.) (Mudani, 1987; Saudi Chambers Council, 1994). Furthermore, the eleven universities in the Kingdom do not have a variety of Master and Doctoral programmes. Moreover, Saudi Arabia has been incurring large budgetary and balance of payments deficits since 1983 (Jasimuddin, 2001). In September 1994, the IMF highlighted Saudi Arabia's rising burden of domestic debt, reaching $84.9 billion by the end of the year (Jasimuddin, 2001).

Finally, it should be mentioned here that around fifteen years ago when many of the economy's problems were becoming apparent, the government had time on its side. A well-thought-out neoliberal reform programme stressing free markets, access to capital, and integration into the world economy could have been undertaken at a safe pace, laying the foundation for the transition to a higher growth path. Instead, the government delayed hard decisions, hoping that a new oil boom would solve the economy's problems. None was forthcoming. Now, the government faces these fundamental problems, such as unemployment rate and poverty rate and overcoming them is becoming more difficult.

2.5.2.2 Demand conditions

In 2000, the population of the Kingdom was about 20 million (Table 2-1). The population growth rate is one of the highest in the world, increasing by an estimated 4.0% per year (Business Monitor International Ltd., 1993). The size of the home market is not large compared to other developed markets, but is attractive to investors since it is the largest market for products and services in the Arab world. In addition, it has access to GCC (Gulf Co-operation Council) markets as well as other Arab countries through its participation in free-trade zones (Jasimuddin, 2001).

Porter (1990) says that the average profitability of an industry is influenced by five forces: rivalry among existing firms; threat of new entrants; threat of substitute products; bargaining power of buyers; and the bargaining power of suppliers (the five forces).

Porter noted that the demand determinants promote a nation's competitive industries. This demand determinant has, to some extent, made the industrial makeup of Saudi Arabia

unique compared with those of most Middle Eastern industrial powers (Jasimuddin, 2001). Because of the openness of the market, the five forces can be seen clearly in the Kingdom. For example, several dairy companies competed aggressively, which pushed prices of their products way down. Therefore, some of the firms could not survive and were close to going out of the market entirely. However, the Ministry of Commerce intervened and negotiated with the companies that make up this industry, which agreed to sell their products at a price reasonable for all.

The demand condition in Saudi Arabia is complicated in virtually every consumer goods industry, such as gold, apparel, shoes, jewellery, cars, furniture, food products, and several others. Saudis may spend more per capita on items such as cars, clothes, accessories, and food than citizens of many other nations (Rateb, 1996). Table 2-7 shows commodity imports in 2001.

Table 2-7 Commodity imports in 2001 (millions SR)

Commodity	Value	%
Foodstuffs	17,925	15.33%
Base metals and metal articles	9,536	8.16%
Electrical machines, equipments & tools	24,062	20.58%
Cars and spare parts	16,629	14.22%
Textiles and clothes	6,556	5.61%
Chemical products	14,119	12.07%
Other commodities	28,104	24.03%
Total imports	**116,931**	**100.00%**

Source: Central Department of Statistics, Riyadh, Saudi Arabia, 2002

The complicated nature of demand conditions in the Kingdom is for several reasons (Alarfaj, 1996). Firstly, Saudi Arabia is a diversified society. Approximately a third of the Kingdom's population is foreigners, each with different cultures, attitudes, and requirements

(Saudi Consulting House, 1994). Secondly, the Saudi market is open, so any business can import products from any country. Thirdly, the standard of living in Saudi Arabia varies (Business Monitor International Ltd., 1993). This variation increases, to some degree, the complication of the demand conditions. Finally, many Saudi citizens love to travel, either for tourism, studying, training, or treatment. Those who do, come back with new or improved demand criteria (Saudi Chambers Council, 1989; Al-Aswaq Magazine, 1996).

2.5.2.3 Related and supporting industries

Mudani (1987) and the Saudi Chambers Council (1987) described the vertical relationship between companies operating in the country or industries as weak, and most companies, excluding the petrochemicals sector, provide products and services to end users. As a result, inputs and machinery are frequently imported (Mudani, 1987; Saudi Consulting House, 1994). The lack of local suppliers creates some disadvantages, summarised as follows (Alarfaj, 1996):

- Inefficient, late, and slow inputs
- Poor co-ordination and linkages between the value chains of firms and their suppliers

The lack of fundamentally related and supporting industries is considered another weakness (Saudi Chambers Council, 1989). This places potential Saudi Arabian competitors at a significant disadvantage vis-à-vis foreign rivals (Alarfaj, 1996).

The establishment of the Saudi Export Development Centre (SEDC) in 1986 and the Saudi Industrial Exports Company (SIEC) in 1989 enables several Saudi Arabian sectors to

benefit. The SEDC was founded to provide the private sector a role of boosting Saudi exports (Saudi Consulting House, 1994). The SIEC was established to develop the export of Saudi industrial products, and to open new markets for local factories, to promote industry and other productive sectors (Alarfaj, 1996). Moreover, Saudi Arabia, by working closely with the International Standards Organisation, is now at the forefront of developing standardised guidelines for industrial exports (Jasimuddin, 2001).

Alarfaj (1996) discussed some factors that may positively affect the relationship between firms in one industry or segment of industry or in one location, summarised as follows:

- There are 19 chambers of commerce and industry in the major cities of the Kingdom. These chambers provide market information and periodically publish guides to existing firms. In addition, each chamber has created several committees, in which each one is responsible for a specific industry in its location (e.g. agriculture, construction, tourism etc.). Periodical meetings are usually organised between business people in each industry.
- The Ministry of Industry has established industrial cities equipped with all facilities in which industrial firms are located close to each other.

2.5.2.4 Company strategies, structures, and rivalry

Table 2-4 shows obviously that most companies operating in the Kingdom are small and medium-sized enterprises. Until 2000, the total number of joint stock companies was 116, constituting 1.14% of the total number of registered firms in the country, and their total capital was SR 72,982,743,176, constituting 46.2% of the total capital of firms. Seventy-two

of the joint stock companies are listed in the Saudi Stock Market (SSM). On the other hand, 88.89% of firms are limited and joint liability partnerships, constituting 52.64% of the total capital of firms. Moreover, many large firms, such as Saudi Telecommunication and the Saudi Airline Company, are mostly owned and controlled by the government.

Several facts contribute to reduce the number of large firms. Firstly, as will be shown in the Chapter Four, the government adopts harsh requirements for firms willing to seek public equity (Butler and Malaikah, 1992). Secondly, Al-Motwa, (1994) says that many people cannot get suitable jobs so their incomes shrink. Consequently, they open new-small businesses to enable them to improve their incomes. Thirdly, the management style and organisational approach adopted is counter-productive (Alarfaj, 1996). People prefer to work on their own or in a close-knit company not to work in hierarchies (Al-Adwan, 1991; Kamel, 1995).

As mentioned previously, small and medium firms are facing some problems, forcing them to close or go bankrupt. Habeb and Abdeen (1987) documented that the most important reasons for a firm's poor financial position and bankruptcy in the Kingdom are establishing businesses without economic feasibility studies and poor management. In addition, Ahmad and Alfuad (1992) tested the role of small businesses in the country and their problems. They suggested that the most important problems that small businesses face are poor management and the structure of the small business industry.

Islam, tribalism, and the West are three major factors influencing the Saudi management style (Atiyyah, 1993; Abuznaid, 1994; Alarfaj, 1996). For example, Saudis - managers and employees alike - dislike working for an anonymous company but wish to feel that they are

members of a family-like organisation where they will be recognised (Hofstede, 1980; Al-Moalmy, 1991).

The Kingdom is an Islamic country and most of its citizens obey the roles and principles of Islam. For example, Islam prohibits alcohol, drugs, stealing, gambling, usury "*Riba*"[12], and monopoly. Islam supports competition that leads to benefit individuals and society as a whole (Alarfaj, 1996).

2.6 Summary

This chapter has attempted to shed further light on the economic background, macroeconomic factors, the contribution of the Saudi Arabian government, the private sector to the economy, and competition in the Kingdom.

The Second part of this chapter reviewed the economic history of Saudi Arabia and the macroeconomic variables and their possible relation with the going public rate. This section showed that Saudi Arabia is required to do more to reduce the oil revenue effect on the GDP and balance of trade. Moreover, the country needs to improve its business environment in order to attract more international investments.

The third section discussed the five years development plans in terms of direction, achievements, and priorities of expenditure on development. Because of its full control of the oil revenue, the Saudi government has played an essential role in the process of development of Saudi Arabia. From an early stage, the government has recognised the importance of the private sector in boosting the economy. Therefore, the government has

[12] Riba is an Arabic word means usury, additional money charged for use of money borrowed.

encouraged the private sector to have more involvement in stimulating the economy by implementing new regulations and adopting reform programmes. This section also presented these new regulations and reform programmes. Some of the policies, especially the privatisation policy, have contributed greatly to improve the liquidity of the SSM which could stimulate more private firms to make IPOs.

The fourth section of this chapter has dealt with the contributions of the private sector to the Saudi economy. The development of the private sector, and challenges faces the private sector were reviewed. It has been shown that the private sector faces many problems such as poor management, harsh competition in many industries, generation shift, and a shortage of financial suppliers. The main question raised in this study is that can going public contribute to solving these problems? This section also presented classification of companies, in term of their legal status, operating in the Kingdom. It has been revealed that in 2000 only 116 out of 10,165 companies were JSCs.

The final part of this chapter discussed competition in Saudi Arabia since the level of competition could be an essential motivate for seeking public fund. The classification of companies, in terms of their success, operating in the Kingdom was presented. In addition, competition in the country was reviewed according to Porter's model. This section showed that the majority of firms compete destructively on prices based on cheap foreign labour. The result is that many companies have either left the market or operate with low profit margins. In order to compete, Saudi companies need to increase their presence in the international market, and should consider setting up companies in developing countries to exploit cheaper labour costs. Industry needs to also increase spending on research and

development, both independently and in cooperation with universities and research institutions.

Finally, although the huge budget deficit aggravated by the costs of the Second Gulf War has been running at unsustainable levels, the economic shock after the War may have been the best thing that happened to Saudi Arabia. The government now is recognising restructuring, and implementing reform programmes more seriously. Moreover, policymakers should recognise the problem of globalisation and justify cutting social benefits. The Kingdom should expedite the privatisation programme, and encourage wholly-owned foreign investment. An extensive effort is needed to join the WTO. In order to provide more opportunity for its private sector and enhance its attractiveness to foreign investors.

3.1 Introduction

The Saudi Stock Market (SSM) is relatively new in age compared to the markets in developed countries. Based on Standard and Poor's Emerging Markets Data Base (EMDB), The SSM is classified as an emerging market belonging to the Middle East and North Africa region[13].

An unofficial stock market started in 1934 when the Arabian Automobile Company was created as the first joint stock company in the Kingdom. The number of joint stock companies increased to a total of five by 1954. By 1964, the total number of joint stock companies had reached 17 with an issued capital of 29.9 million shares and a value of SR 2,955 million (Al-Razeen, 1999). In September 2004, the number of joint stock companies in the Kingdom was 116 and just 72 of them were listed in the SSM.

Additionally, the sharp increase in oil revenue in 1970s, the adoption of a privatisation programme, the issuing of the Companies Act in 1965, the establishment of a stock exchange in neighbouring countries (Kuwait and Jordan), and the establishment of 19 new public firms made the public more interested in investing in stocks and also made Saudi private firms to consider the options of going public.

[13] EMDB classifies a stock market as "emerging" if it meets at least one of two general criteria (International Finance Corporation, 2001):

- It is located in a low- or middle-income economy as defined by the World Bank
- Its investable market capitalisation is low relative to its most recent GNI (Gross National Income) figures

The importance of this chapter comes from the fact that it explores the most of the issues related to the SSM and could have effects on the IPO activities in the Kingdom. For instance, several researchers, such as Ritter (1991) and Laughran and Ritter (1995) documented empirically that more companies seek public equity when there is a sharp stock price increase. Therefore, one of the objectives of this chapter is to examine the performance of the SSM, the main market sectors and the listed JSCs.

Besides investigating the performance of the SSM, the main market sectors, and the JSCs, this chapter is aimed to provide an overview of the Saudi Arabian Monetary Agency, the main body responsible about the SSM. The development of Saudi primary and secondary markets and share trading activity in the SSM are presented. In addition, there is a close look at the participants, the liberalisation, the characteristics, and the efficiency of the SSM.

3.2 The Saudi Arabian Monetary Agency (SAMA)

On the 4th of October 1952, SAMA was founded as the Central Bank of Saudi Arabia. SAMA is one of the main government agencies that played an important role in developing monitoring the Saudi financial system and the SSM.

At the time of its establishment, the Kingdom did not have a monetary system exclusively its own. Foreign currencies circulated in the Kingdom as a medium of exchange, along with Saudi silver coins. Saudi bank notes had not yet been issued. One of the most important functions of SAMA in its early stages was to develop a Saudi currency. In the 1960s, SAMA focused on banking regulations and promoting the

growth of national banking. In the 1970s and early 1980s, SAMA's concern was to contain inflationary pressures in the booming economy, expand the banking system, and manage the huge foreign exchange reserves. From the mid 1980s, SAMA's intention was to introduce financial market reforms and advise the government on managing public debt. Over the years, with the growth of the economy and expansion of the financial system, SAMA's responsibilities have increased and its activities can be classified as follows (Saudi Arabian Monetary Agency, 2003):

- Controlling and monitoring the daily stock market transaction
- Regulation of the money supply
- Advising the government on public debt
- Stabilisation of the external value of the Riyal
- Supervision of banking activities and the financial system
- Acting as a banker to the government
- Managing the Kingdom's foreign exchange reserves
- Conducting financial and economic research

Furthermore, in 1984 SAMA took over control of the capital market in Saudi Arabia and became the legislative body that regulates general and operational rules. SAMA circulated to commercial banks, responsible for all share-trading activities, the rules and regulations controlling and supervising the SSM. SAMA's role in regulating and stabilising the money supplies is to maintain the internal and external value of the currency, hold and operate any monetary reserves funds as separate funds earmarked for monetary purposes only, buy and sell for the government account gold and silver bullion,

and to give advice to the government about new coinage and to handle the manufacture, shipment, and issue of all coins (Al-Mubarak, 1997).

Additionally, SAMA participates in the development of the financial system by implementing several automated systems (Saudi Arabian Monetary Agency, 2003). For instance, SAMA introduced an electronic share information system (ESIS) in 1990 (ESIS will be discussed fully later in this chapter).

Furthermore, SAMA has a Research Department, responsible for collecting and analysing data needed to assist the government and its agencies in formulating and carrying out financial and economic policies (El-Mallakh, 1982).

Finally, it should be said here that despite SAMA is the main body responsible about the most of the SSM activities, such as, handling day-to-day market operations, analysing the daily negotiation transactions, and determining the starting date of share trading of the newly listed companies, there is another important agency responsible about some of the SSM activities which is the Ministry of Commerce (MOC). MOC is accountable about many essential issues such as making sure that JSCs complies with the financial information disclosure requirements, and granting permissions to firms want to make IPOs.

Unfortunately, these two agencies sometimes have public conflicts about certain issues. This conflict always negatively affects the performance of the SSM and also reduces the trust and confidence of investors and private companies. One good example of this conflict is that, in October 2004, the plans for an initial public offering of shares by

Ettihad Etisalat Co., the entity that won the second GSM licence in Saudi Arabia, ran into some controversy and public conflict between MOC and SAMA. On October 4, SAMA announced that the subscription would begin on October 16. However, MOC announced on October 5 that Ettihad Etisalat Co. could not invite the public to subscribe for the company's shares on October 16 and subscription could only begin after the company had officially been established. The contradictory announcements from the two agencies was a severe blow to the SSM, which is said to have lost 7 billion Saudi Riyals in just a few days (the loses happened because daily investors, after the announcement that the subscription would begin on October 16, started to sell their stock at the market price in order to use the money to subscribe for the offering).

Therefore, because of conflicts between the two agencies, some academics and investors have requested that the government should create a single agency to be responsible for all the SSM activities (Al-Watan, 2002).

3.3 The primary market

Primary markets facilitate the issuance of new securities; primary market transactions provide funds to the initial issuer of securities; the issuance of new corporate stock or new treasury securities represents a primary market transaction (Madura, 1998).

As mentioned at the beginning of this chapter, the start of the primary market was in 1934 when the Arabian Automobile Company offered its shares to investors. From 1976 to 1980, the Saudi economy witnessed a dramatic growth rate because of a boom in oil revenues. The result was the primary market marked its then biggest jump in the number

of publicly traded companies, when 19 new companies were offered to the public (Felemban, 1989).

3.3.1 Cases of privatisation

It has been in Chapter Three that the government uses the privatisation policy to strengthen the SSM. The Saudi government had an essential role in stimulating the primary market by being involved in the formation of many stock companies through its secondary investment agencies such as the Retirement Pensions Agency and the General Organisation for Social Insurance. On 17-12-2002, the primary market witnessed its biggest jump in terms of value, when the Saudi government decided to privatise 30% of the capital of the Saudi Telecommunications Company (STC) with a value of $ 4.00 billion. The second biggest jump, in terms of value, was in 1984, when the Saudi government also decided to sell 30% of the capital of the Saudi Basic Industries Corporation (SABIC) with a value of $ 800 million.

3.3.2 Cases of going public

Unfortunately, there is no list of cases of IPOs in Saudi Arabia. Information about companies that went public in the Kingdom has been obtained from newspapers and by asking all the companies listed in the stock market if they had made an IPO. The researcher was able to identify the companies that went public from the late eighties until now. Just ten IPO cases occurred in Saudi Arabia from 1988 until 2004[14].

[14] To the best of the researcher's knowledge, there is no empirical study conducted to investigate the reasons behind the low number of IPOs in the Kingdom. However, this matter is one of the objectives of this study.

Table 3-1 shows the cases of IPOs in Saudi Arabia from 1988 until 2004. The first case of going public in SSM was in 1988, when Al-Rajhi Bank switched to public equity, with an initial capital of SR 750 million. Its current authorised and paid up capital is SR 2.25 billion. The private sector owns 98.92% of its shares and the Saudi government owns 1.08%. Al-Rajhi Bank is currently engaged in banking and investment operations on its own account and/or on behalf of its customers, in Saudi Arabia and abroad, through its wide network of more than 500 branches. Until 2003, the total number of employees was 5,015.

Table 3-1 Summary of the companies that went public in S.A. and are listed on SSM

Company	Year of going public	Year of Establishment	Sector
Al-Rajhi Bank	1988	1976	Bank
Saudi Cable	1988	1975	Industry
Al-Mubarad	1991	1984	Service
Saudi Arabian Amiantit	1994	1968	Industry
Al-Mukairish (merging with Al-Mawashi)	1995	N/A	Service
Alazizia Panda (merging with Savola)	1998	N/A	Industry
Ahmed Fitahi	1998	1992	Service
Al-Zamil	1998	1977	Industry
Saudi Chemical	1998	1972	Industry
Jarir Marketing	2004	1990	Service

In 1988, the SSM witnessed another case of going public, when the Saudi Cable Co. offered its shares to outsiders. Its current authorised and paid up capital is SR 500 million and the private sector holds 100% of its shares. The company activities are the manufacturing and marketing of electrical wooden reels and pallets, and providing turnkey project services for power and telecom projects including design, engineering, installation and finance. Until 2003, the total number of employees was 1,100.

The third IPO case was when Al-Mubarad Co. offered its shares to outside investors in 1991. Its current authorised and paid up capital is SR 180 million and the private sector owns 100% of its shares. Al-Mubarrad's activities are transport, transfers, and handling of cargo for various materials from Saudi Arabia and abroad. It also provides construction, management and leasing of cold stores, trailers, machinery, and related equipment.

Saudi Arabian Amiantit Co. was the fourth private company that went public, when it converted to a Saudi joint stock company in January 1994. Its current authorised and paid up capital is SR 700 million. The Company's activities are: establishing, owning, managing and operating industrial projects as well as marketing their products in relation to the company's business. In 2002, the total number of its employees was 1,600.

Another case of going public gained its experience in 1995, when Al-Mukairish Co. went public by merging with Al-Mawashi Co. Current authorised and paid up capital is SR 1.2 billion and the private sector holds 100% of its shares. The company's activities are livestock, marine transport operations in Saudi Arabia and abroad, ownership of land and plant necessary for the company's trade in marine equipment, fodder, and other activities related to the production and transport of meat, management and operation of slaughter houses, and the processing of meat.

In 1998, Alazizia Panda United became a public company when it merged with Savola Co. and the name became the Savola Group. Its current authorised and paid up capital is SR 800 million. The private sector holds 92.56% of its shares and the Saudi government

holds 7.44%. Its activities are manufacturing and marketing of oil and vegetable ghee. The total number of its employees in 2002 was 5,130.

In 1998, the SSM witnessed the seventh case of an IPO, when Ahmed Fitahi Co. converted to a joint stock company. Its authorised and paid up capital is SR 200 million and all of its shares are owned by the private sector. Fitahi's activities are manufacturing of gold, silver, jewellery, and trading in other related accessories and household goods.

Another case of an IPO came into being in 1998, when Al-Zamil Co. went public after floating 40% of its shares to Saudi and Gulf investors. Its current authorised and paid up capital is SR 300 million. The company's activities are manufacturing, selling, supplying, maintaining steel buildings, air conditioners, and architectural glass.

In 1998, Saudi Chemical Co. was the ninth private company converted a joint stock company. Its current authorised and paid up capital is SR 465 million. The company's activities include manufacturing of explosives for military and civil uses such as rock blasting for road cutting and foundations, trench blasting for oil and water pipe lines, and tunnelling for roads and for mining. The total number of its employees in 2002 was 234.

The latest company to make an IPO in the Kingdom is Jarir. Jarir Marketing Company was converted to a joint stock company in 2004 with a paid up capital of SR 240 million, par value per share SR 50. The private sector owns 100% of its shares. Its activities are importing school stationery, office supplies, computer equipment, books, and technical and engineering tools for wholesale and retail markets in Saudi Arabia. The company has

also developed two trademarks, namely Rocco and Royal Falcon. The total number of employees was 730 in 2003.

Finally, it can be said here that the capital size of the IPOs is small compared to the rest of the market. For example, when Jarir Co., the only company that made an IPO in that year, went public in early 2004, the capital average market capital size was SR 1,720,862,507 while Jarir Co.'s capital size was only SR 240,000,000. Moreover, Table 3-1 shows that most of the IPOs are working in the industry sector, have long operation history, and large number of employees.

3.4 The secondary market

Secondary markets facilitate the trading of existing securities; the sale of existing corporate stock or treasury security holdings by any business or individual represents a secondary market transaction (Madura, 1998).

Because of its high profitability and low risk, during the 1970s the public was largely interested in investing in the real estate sector. However, with the establishment of stock exchanges in neighbouring Jordan and Kuwait, the public began to gradually shift focus towards investment in Saudi stocks. Investment in Saudi shares became especially popular in the early 1980s. Secondary market activity further rose in terms of the number of transactions and value of shares traded as a result of the implementation of the government's development plans, the Saudisation of local banks, and the formation of many new joint stock companies (Felemban, 1989).

Prior to 1985 the SSM was a completely unregulated market. However, after the collapse of the Kuwait stock market in 1984, the Ministerial Committee issued new rules and regulations to monitor and control the share trading activities effective from first of January 1985. At that time, there were 38 joint stock companies having a total capital of $4.03 billion (Azzam, 1988, p. 80).

3.4.1 The Share Negotiation System (SNS)

According to the 1985 regulations, negotiations and dealing operations for Saudi joint stock companies' shares were to be made only through Saudi commercial banks. The commercial banks act as intermediaries in share sale/ purchase transactions on behalf of their clients and are prevented from buying or selling shares for their own interest (Saudi Arabian Monetary Agency, 1985). The reasons for not allowing the commercial banks to invest in the SSM are that, first, banks have enormous resources and monetary power, which could shape the market and control decision making by companies (Al-Saleh, 1997). Second, the regulations forbid foreign investors to participate fully in the SSM and most commercial banks are partly owned by non-Saudi citizens[15].

All commercial banks operating in the Kingdom are required to have a Central Trading Unit (CTU) based in the capital city (Riyadh) to receive share sales and purchase orders from their branches, which also have to have their own CTU, and affect negotiations accordingly with other banks through their CTUs in Riyadh.

[15] It will be shown later in this chapter that the regulations allow non-Saudi citizens only to invest in the SSM through special funds established and controlled by local commercial banks.

The share negotiation process works in the following fashion (Al-Razeen, 1999). People wishing to sell or buy stocks in the market go to a branch negotiation unit at any commercial bank and sign an application form authorising the bank to execute the transaction on their behalf. The application form consists of information concerning their identity and the quantity of shares they wish to sell or buy. The commercial banks benefit by collecting a commission based on the transaction value to a maximum of 1% paid by both the seller and the buyer on an equal basis. The clients can determine the kind of order they want to place. There are two types of orders. The first is a limited order, in which the clients specify the price for any shares they wish to buy or sell. In such cases, the bank cannot change the price without the client's permission. The second type is a market order by which the client allows the bank to select the best price available on the market to execute the order. Since 2002, people are allowed to sell or buy shares via the phone and the internet.

The system imposes the following strict rules in order to protect the market from any misbehaviour (Al-Mubarak, 1997):

- The employees in the Banks' CTU are forbidden from negotiating shares for their own account or for their next-of-kin or relatives
- Payment of transaction values is to be made in a form of immediate and full settlement by cash, certified cheque, or by authorisation to debit an account

3.4.2 The Electronic Securities Information System (ESIS)

Several countries have automated their traditional stock exchanges. These stock exchanges have benefited from automation to improve operational efficiency, accuracy of trading, settlement processing, and information dissemination, in addition to enhancing surveillance and better tracking of trades (Saudi Arabian Monetary Agency, 2003).

In 1990, SAMA launched ESIS. This new system was implemented because of the development of the secondary market and SAMA designed it to increase operational efficiency and accuracy of the trading process. The objectives of ESIS are (Saudi Arabian Monetary Agency, 2003):

- Centralising all information about trading transactions in a computer bank located at SAMA
- Providing investors with up-to-the minute bid and ask orders, quantities, prices, financial information, and announcements by joint stock companies
- Improving the appearance of fairness, which is important for small investors, by executing transactions as soon as they are entered into the system
- Improving market liquidity by ensuring that transactions are executed instantly
- Improving the efficiency and speed of communication between intermediaries and the stock market

By adopting and implanting this ESIS technology, the following have been achieved (Gulf Base, 2002):

- **Information transparency:** through terminals available in 500 branches of domestic and overseas banks, ESIS provides market participants with instantaneous bid and offer prices as well as executed quantities and prices.
- **Fairness:** ESIS provides fairness by allowing equal access to the market for all participants without exception. The system is available to participants during the morning and evening hours in 150 branches of banks throughout the Kingdom, where transactions are executed electronically according to price and time priorities.
- **Narrow price spreads:** the quality of pricing in the system contributes to narrow price spreads between buy and sell orders where prices are set around market averages.
- **Efficient trading cycles:** efficient electronic trading provides fast communication between mediators, buyers, and sellers. Compared with other countries, settlement, transfer of ownership, and issuance of ownership documents through ESIS delivers the settlement transaction in the shortest amount of time. The percentage of settlements executed on the same day is 90%; the average of transactions settled on time is 99.7% of the total executed transactions. This is considered one of the best averages in the world.
- **Liquidity:** because of the speedy execution of transactions and the instant automatic availability of information to participants, liquidity prevails in the equities market.
- **Control and security:** ESIS provides control and security to participants by guaranteeing the collection of money (in cash) for participants by the banks

according to precise accounting procedures continuously controlled and supervised by SAMA.

3.5 The SSM indices

It is crucial for this study to review the performance of the SSM and its sectors as, firstly, IPOs tend to occur more frequently during bullish stock market periods, when potential investors are more interested in purchasing new stock (Madura, 1998). Additionally, Ritter (1984) and Loughran *et al.* (1994) found that the rate of going public is positively correlated with the stock market valuation of firms in the same industry. Pagano *et al.* (1998) found, systematically, that more IPOs occur when the average market-to-book (MB) ratio of public firms in their industry is higher[16]. Secondly, the current study attempts to find whether the floatation decision is associated with particular kind of companies. For example, previous literature found that companies working in industrial sector are more likely to seek public equity (Torres, 1997).

Hence, the next subsections discuss the performance of the SSM and the SSM sectors. However, before reviewing that, the following subsection explains how the SSM indices are calculated and what the effect of the largest 10 Saudi JSCs on it, as the performance of these companies has a huge impact on the SSM general index.

3.5.1 The calculation of the SSM indices

The National Centre for Financial and Economic Information (NCFEI), which is under SAMA control, launched its market indices for the first time in February 1985 with a

[16] More discussions about these studies and other studies will be presented in Chapter Five.

base of 1000 points. First, the indices were introduced on a trial period for two years. Then, the indices became the official indices of the SSM and were made available to the public on the 6th of March 1987. The general Saudi Stock Index is calculated as follows:

1. The market value of every company listed in the stock market is calculated (number of shares issued X closing market price = current market value).
2. The total current market value for the index as a whole is calculated. This is done by adding up the market values of all companies in the index.
3. The index = the total market value of all the companies listed / average divisor[17].

Table 3-2 shows the effect of the largest 10 companies listed in the SSM on the general market index. These 10 companies consist of 78.20% of the total market value and if the share prices of these ten companies increase by SR 1, that would add 13.42 points to the general index. If the shares of the other companies listed in the stock market, which are sixty two companies constituting just 21.77% of the SSM value, increase by SR 1, that would just add 4.92 points to the general index.

Because of this situation, the small-company stock prices, which are the majority, usually follow the performance of the large companies. Thus, many voices are asking the responsible governmental bodies to adopt new steps which could reduce the effects of these 10 companies on the general stock market index (Al-Rabi, 2004). One of the suggestions is to divide the index into two indices, one for large companies and the other is from small companies. Another suggestion is to change the way that the general Saudi stock index is calculated. For example, one method would be to remove non-tradable

[17] The average divisor was 135050522 in September 2004.

shares, such as the shares owned by the government, from the total number of shares issued. However, this is a short term solution and the problem can be solved in the long run by privatising some of the large state-owned companies and also by persuading more private companies to go public.

Table 3-2 The effect of the ten largest companies in the SSM on the general index (All numbers were calculated on September 2004)

Company	% of its weight in general index	Number of Issued shares	Value of general index will change (point) if the share price increase/decrease 1 SR
The Saudi Telecom Co.	20.1%	300,000,000	2.22
SABIC	16.8%	300,000,000	2.22
The Saudi Electricity Co.	14.0%	833,318,763	6.17
Al-Rajhi Bank	7.0%	45,000,000	0.33
SAMBA Financial Group	4.9%	80,000,000	0.59
Riyadh Bank	4.1%	80,000,000	0.59
The Saudi French Bank	3.9%	45,000,000	0.33
The Saudi British Bank	3.1%	50,000,000	0.37
The Arab National Bank	2.8%	40,000,000	0.30
SAFCO	1.5%	40,000,000	0.30
Total	**78.20%**	**1,813,318,763**	**13.42**
The other 62 listed companies	**21.80%**	**664,723,248**	**4.92**

3.5.2 The performance of the SSM

From 1986 to 2000, the SSM activities and performance have been affected by five main issues:

1. The first Gulf War from 1980 to 1988
2. The second Gulf War from 1990 to 1991
3. The economic boom after the second Gulf War from 1991 to 1993
4. International economic slowdown after the second Gulf War started in 1993
5. The drop in oil prices in 1998

Table 3-3 shows the yearly average share price index by all sectors for the period from 1985 to 2002. This table shows that the general index was 1000 points when it was first started. In 1985, the share price index was only 690.88 points. In 2002, the general price index reached 2518.08 points (a 264.47% increase).

After the second Gulf War, the general index witnessed its biggest jump when it increased by 80% in 1991 (Table 3-7). However, the general index declined five times; it declined 6% in 1986 due to the first Gulf War and low oil prices; it declined 10% in 1990 because of the second Gulf War; it declined 5% and 28% in 1993 and 1994 because of the international economic slowdown after the second Gulf War; it declined 28% in 1998 due to the low oil prices at that time.

Table 3-3 Share price index by sectors (beginning of 1985 = 1000)

End of period	General Index	Banking	Industry	Cement	Services	Electricity	Agriculture
1985	690.88	689.19	791.75	755.87	690.01	700.44	847.96
1986	646.03	567.64	680.49	627.65	623.79	702.97	909.23
1987	780.64	838.26	941.54	595.44	704.31	816.58	1161.81
1988	892.00	1257.73	1433.93	708.83	648.14	671.50	1181.05
1989	1086.83	2185.08	1631.11	983.14	613.38	571.02	1122.73
1990	979.77	1900.93	1428.13	947.22	574.76	539.52	1011.05
1991	1765.24	4276.23	2867.69	1382.70	1175.91	592.34	1362.13
1992	1888.65	4987.16	2590.06	2100.21	1377.52	603.58	1549.69
1993	1793.30	4913.04	2221.08	1933.37	1243.22	626.24	1101.87
1994	1282.87	3069.19	1906.90	1424.48	870.48	471.95	766.79
1995	1367.60	3278.40	2497.80	1371.60	682.20	425.60	689.40
1996	1531.00	3968.50	2695.20	1792.40	659.10	420.80	618.80
1997	1957.80	5596.70	3149.10	2041.20	762.30	570.10	645.90
1998	1413.10	4344.80	1984.00	1271.10	598.80	460.40	498.10
1999	2028.53	6438.95	2917.91	1682.16	589.17	697.98	454.97
2000	2258.29	7229.53	3514.01	1735.29	568.65	705.05	457.50
2001	2256.07	7080.63	3564.22	1794.29	578.35	717.22	475.53
2002	2518.08	7741.92	3220.56	3227.66	794.66	837.85	575.31

Additionally, Tables 3-4, 3-5, and 3-6, show the share trading activities from 1985 to

shares, such as the shares owned by the government, from the total number of shares issued. However, this is a short term solution and the problem can be solved in the long run by privatising some of the large state-owned companies and also by persuading more private companies to go public.

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1989	1086.83	2185.08	1631.11	983.14	613.38	571.02	1122.73
1990	979.77	1900.93	1428.13	947.22	574.76	539.52	1011.05
1991	1765.24	4276.23	2867.69	1382.70	1175.91	592.34	1362.13
1992	1888.65	4987.16	2590.06	2100.21	1377.52	603.58	1549.69
1993	1793.30	4913.04	2221.08	1933.37	1243.22	626.24	1101.87
1994	1282.87	3069.19	1906.90	1424.48	870.48	471.95	766.79
1995	1367.60	3278.40	2497.80	1371.60	682.20	425.60	689.40
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2002	2518.08	7741.92	3220.56	3227.66	794.66	837.85	575.31

Additionally, Tables 3-4, 3-5, and 3-6, show the share trading activities from 1985 to

2002 in terms of the number of shares, the value of shares, and the number of share transactions for each sector. (Tables 3-3, 3-4, 3-5, and 3-6 are taken from Saudi Arabian Monetary Agency, 2003).

Figure 3-1 The value of the SSM indices

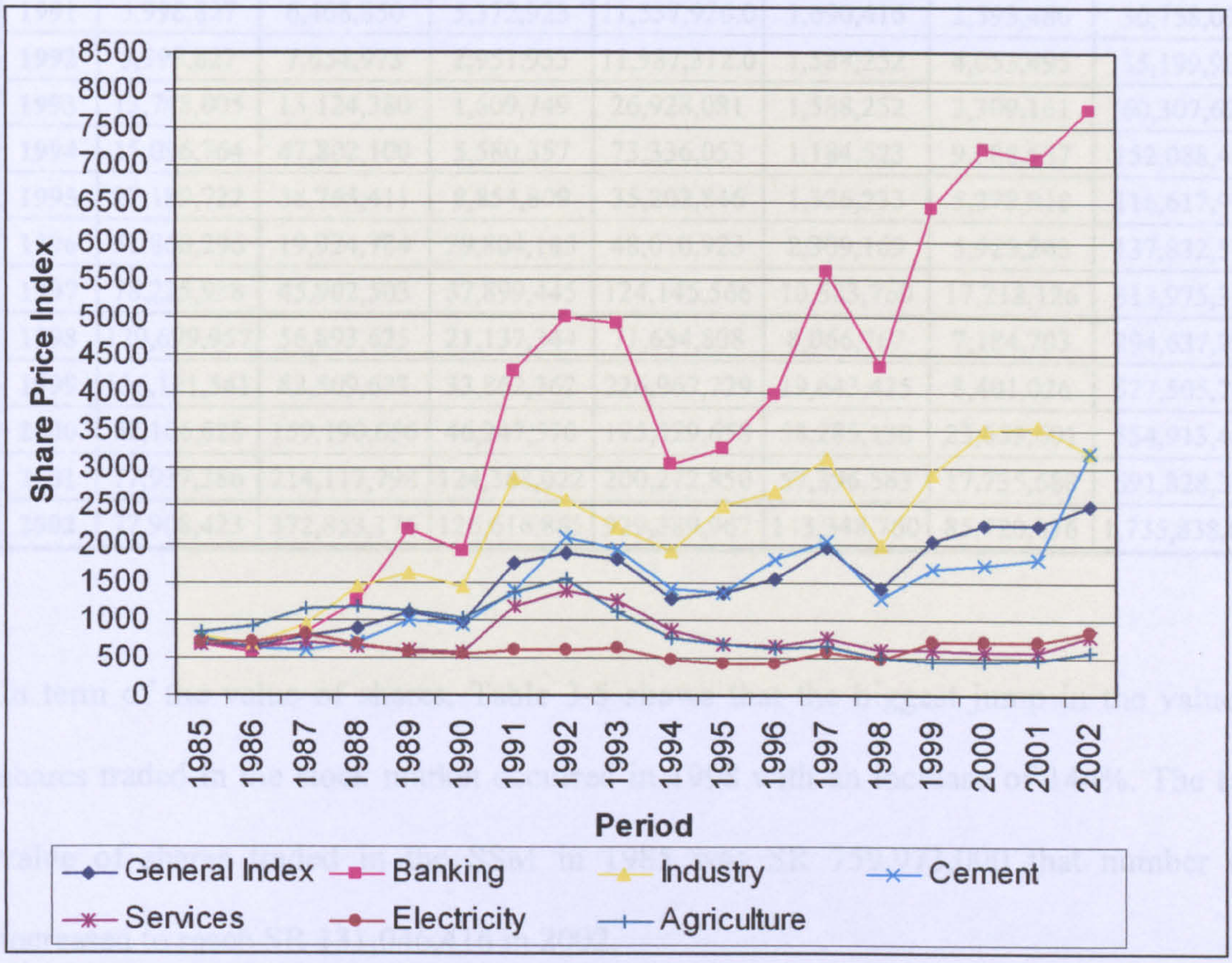


Table 3-4 shows the total number of shares traded in the SSM in 1985 was 3,936,338. That number had escalated to reach 1,735,838,067 in 2002. The biggest jump in the number of shares traded in the stock market occurred in 1994 with an increase of 152.19%. But, this increase did not include the shares of all companies. The number of shares traded increased for 40 companies only, decreased for 20 companies, and the shares for the remaining companies were not traded in 1993-1994 (Al-Mubarak, 1997).

Table 3-4 Number of shares traded by sector

Period	Banking	Industry	Cement	Services	Electricity	Agriculture	Total
1985	442,648	810,118	492,636	751,732	1,173,533	265,671	3,936,338
1986	781,420	422,116	422,116	1,386,350	1,084,384	788,226	5,263,001
1987	859,618	3,272,877	3,272,877	2,774,331	1,790,255	1,933,126	12,012,324
1988	1,209,975	4,949,985	2,799,759	2,506,681	1,583,858	1,591,069	14,641,327
1989	2,576,299	4,500,932	2,790,855	3,540,923	977,060	885,784	15,271,853
1990	2,453,089	4,236,573	4,126,478	3,660,715.0	1,518,901	942,630	16,938,386
1991	5,998,827	6,408,850	5,372,923	11,557,926.0	1,690,416	2,593,480	30,758,077
1992	5,998,827	7,654,973	2,951,953	11,987,312.0	1,588,252	4,053,495	35,199,907
1993	13,748,005	13,124,380	1,609,749	26,928,081	1,588,252	3,309,161	60,307,628
1994	15,096,764	47,802,100	5,580,357	73,336,053	1,184,523	9,088,637	152,088,434
1995	27,189,722	38,765,411	8,854,809	35,202,846	1,326,233	5,278,918	116,617,939
1996	31,860,296	19,924,784	29,804,145	48,010,923	2,309,169	5,923,243	137,832,560
1997	78,225,938	45,902,503	37,899,445	124,145,566	10,583,760	17,218,126	313,975,338
1998	129,699,957	56,893,625	21,137,344	71,654,808	8,066,767	7,184,703	294,637,204
1999	156,121,541	82,509,623	33,862,362	226,967,729	19,643,425	8,401,026	527,505,706
2000	92,106,828	159,190,656	46,247,570	175,429,658	58,285,130	23,653,601	554,913,443
2001	77,937,386	214,117,798	124,368,022	200,272,850	57,396,563	17,735,688	691,828,307
2002	77,908,423	372,853,176	126,616,865	929,389,967	143,348,760	85,720,876	1,735,838,067

In term of the value of shares, Table 3-5 shows that the biggest jump in the value of shares traded in the stock market occurred in 1998 with an increase of 144%. The total value of shares traded in the SSM in 1985 was SR 759,973,000 that number had increased to reach SR 131,046,416 in 2002.

Table 3-5 Nominal value of shares traded by sector (thousands SR)

Period	Banking	Industry	Cement	Services	Electricity	Agriculture	Total
1985	181,848	151,319	116,034	66,734	198,656	45,382	759,973
1986	293,570	131,713	55,685	92,594	153,755	103,432	830,749
1987	297,808	293,881	365,816	207,697	291,591	228,724	1,685,517
1988	530,237	726,322	215,717	173,591	291,591	160,524	2,097,982
1989	1,616,859	989,815	328,894	214,152	119,192	94,774	3,363,686
1990	2,257,328	1,027,492	614,522	231,383	167,972	104,538	4,403,235
1991	3,612,744	2,219,467	949,457	1,343,938	194,416	207,285	8,527,307
1992	7,096,200	2,942,903	865,047	2,060,669	311,134	422,879	13,698,832
1993	8,642,496	3,518,526	479,485	4,162,184	213,169	344,174	17,360,034
1994	6,189,320	8,056,416	976,496	8,935,826	129,630	583,387	24,871,076
1995	7,832,275	10,383,196	1,403,662	3,199,003	120,135	288,320	23,226,590
1996	10,406,069	5,717,344	5,341,778	3,456,396	186,448	289,294	25,397,330
1997	29,279,641	11,009,473	8,156,547	11,571,535	1,132,184	910,976	62,060,356
1998	32,820,282	9,520,069	3,484,102	4,557,806	788,844	338,056	51,509,159
1999	34,870,322	10,236,345	3,789,893	6,085,512	1,372,636	224,015	56,578,723
2000	29,520,066	20,392,121	5,238,310	4,820,035	4,646,031	676,324	65,292,887
2001	24,384,963	26,206,565	20,789,107	7,216,473	4,485,812	518,394	83,082,920
2002	25,961,367	32,545,725	27,584,380	33,790,147	11,164,797	2,740,661	131,046,416
Average	**12,544,078**	**8,114,927**	**4,486,385**	**5,121,426**	**1,442,666**	**460,063**	**31,988,487**
Average growth rate	**39.8%**	**41.2%**	**73.4%**	**77.4%**	**52.8%**	**57.4%**	**34.3%**

Table 3-6 shows the number of share transactions from 1985 to the 2002. In 1985, there were just 7,842 transactions. In 2002, the number of transactions had jumped to reach 1,033,669 transactions (a 13,081% increase)

Because of the second Gulf War, the number of transactions declined in 1990 and had not increased greatly in 1991. However, the biggest increase was in 1992 when the number of transactions jumped 200%.

Table 3-6 Number of share transactions by sectors

Period	Banking	Industry	Cement	Services	Electricity	Agriculture	Total
1985	1,507	1,731	709	1,801	508	1,586	7,842
1986	1,896	2,928	931	2,215	766	2,097	10,833
1987	3,653	6,895	1,447	4,819	1,083	5,370	23,267
1988	7,212	15,273	2,589	7,488	1,265	8,133	41,960
1989	54,824	17,967	4,053	19,746	1,178	12,262	110,030
1990	30,032	17,237	4,948	22,057	1,165	9,859	85,298
1991	23,115	23,957	4,862	26,764	1,179	10,682	90,559
1992	79,656	95,741	8,271	65,176	2,021	21,210	272,075
1993	114,370	101,307	8,182	75,159	2,150	18,414	319,582
1994	67,834	112,279	13,285	138,960	1,935	22,887	357,180
1995	82,817	98,662	19,921	74,438	2,002	13,902	291,742
1996	89,328	59,734	49,100	69,308	3,496	12,793	283,759
1997	139,931	97,654	62,976	126,148	11,349	21,998	460,056
1998	167,547	90,176	36,173	64,541	8,780	9,400	376,617
1999	166,422	105,729	44,495	96,247	17,099	8,234	438,226
2000	119,576	172,321	58,663	81,589	50,568	15,418	498,135
2001	114,071	196,010	135,751	111,961	33,065	14,177	605,035
2002	105,218	279,289	132,181	373,797	87,025	56,159	1,033,669

It can be seen from these tables that the SSM is not stable. To test the volatility and profitability of the SSM, it was compared with the Jordanian Stock Market (JSM), the S&P 500, and London FTSE 100 (Table 3-7). On average, the SSM outperformed the three markets in the period 1986 to 2002. The SSM, S&P 500, and London FTSE 100 had negative returns five times and the JSM had negative returns seven times in the same period. However, Table 3-7 also shows that the SSM is the most volatile market with a standard deviation of 0.26. This is not surprising since high risk usually associated with high return[18].

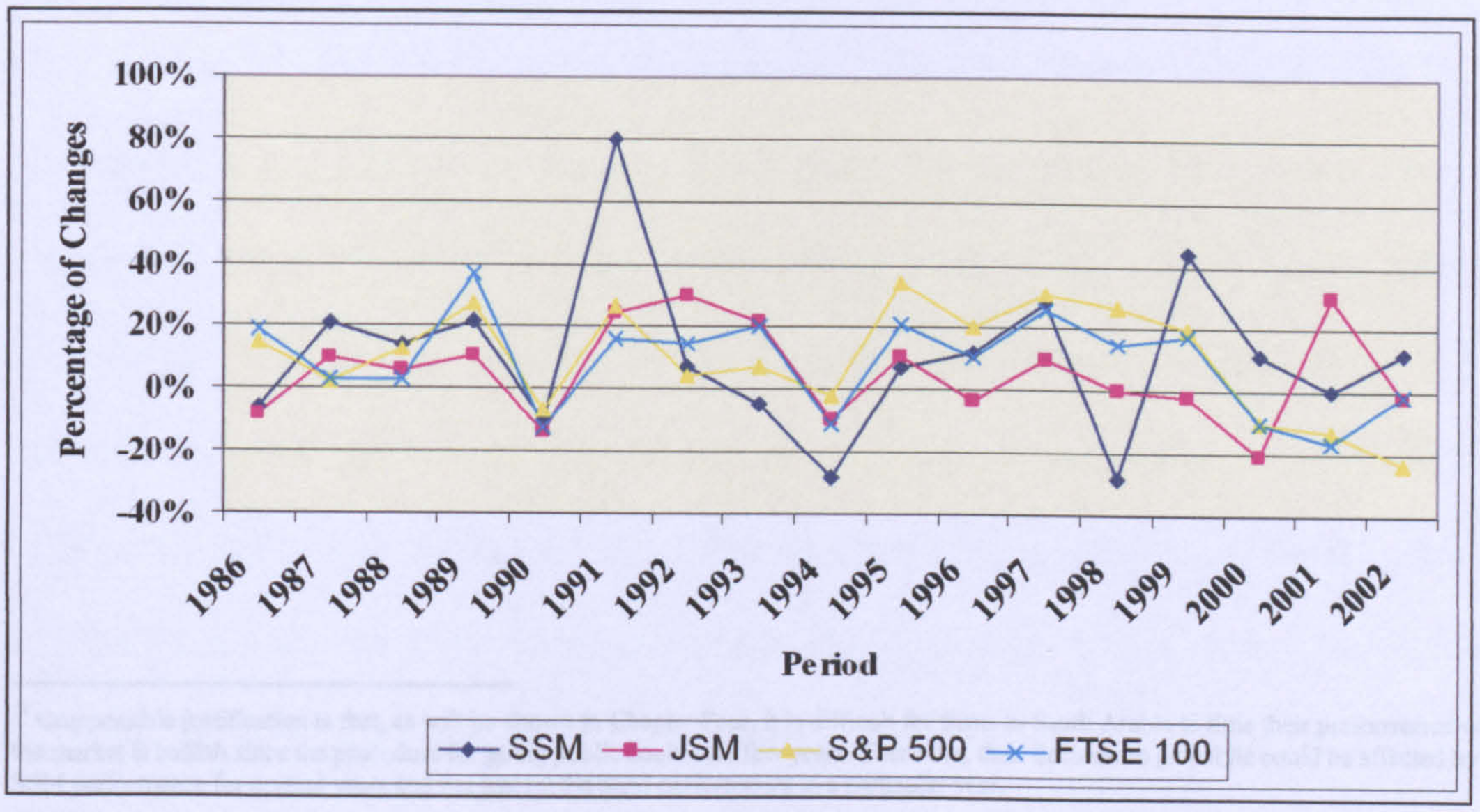
[18] Finance professor Harry Markowitz began a revolution by suggesting that the value of a security to an investor might best be evaluated by its mean, its standard deviation, and its correlation to other securities in the portfolio. He suggested that stocks provide the highest return, but with the highest risk.

Table 3-7 Percentage changes in the SSM index and other markets

Period	SSM	JSM	S&P 500	FTSE 100
1986	*-6.49%*	*-7.89%*	14.62%	18.79%
1987	20.84%	10.08%	2.03%	3.11%
1988	14.27%	6.02%	12.40%	3.13%
1989	21.84%	10.41%	27.25%	36.91%
1990	*-9.85%*	*-13.83%*	*-6.56%*	*-12.26%*
1991	80.17%	24.38%	26.31%	15.88%
1992	6.99%	29.90%	4.46%	14.45%
1993	*-5.05%*	22.02%	7.06%	20.60%
1994	*-28.46%*	*-9.40%*	*-1.54%*	*-10.64%*
1995	6.60%	10.86%	34.11%	20.68%
1996	11.95%	*-3.58%*	20.26%	10.39%
1997	27.88%	10.23%	31.01%	25.89%
1998	*-27.82%*	0.53%	26.67%	15.06%
1999	43.55%	*-1.59%*	19.53%	17.27%
2000	11.33%	*-20.49%*	*-10.14%*	*-10.21%*
2001	*-0.10%*	29.75%	*-13.04%*	*-16.15%*
2002	11.61%	*-1.56%*	*-23.37%*	*-1.01%*
Average	**10.54%**	**5.64%**	**10.06%**	**8.93%**
Standard Deviation	**0.26**	**0.15**	**0.17**	**0.15**

Figures in italic are negative returns.

Figure 3-2 Percentage changes in the SSM index and other markets



Interestingly, by observing Table 3-1, four out of ten IPOs occurred in Saudi in the last 16 years were in 1998 and in the same time Table 3-7 showed that the SSM had strong negative performance, -27.82%, in that year[19].

3.5.3 The performance of the SSM sectors

Up to September 2004, there were 72 joint stock companies listed in the SSM. These companies are classified into seven major sectors as follows:

There are twenty six companies in the industrial sector, eighteen in the service sector, nine in the banking sector, nine in the agriculture sector, eight in the cement sector, one in the electricity sector, and one in the telecommunication sector. Table 3-8 shows the percentage of changes in share price indices for each sector.

[19] One possible justification is that, as will be shown in Chapter Four, it is difficult for firms in Saudi Arabia to time their performance when the market is bullish since the procedure for going public could take few years. Therefore, their decision to go public could be affected by the SSM performance for several years and not just by the SSM performance in a particular year.

Table 3-8 Percentage changes in share price indices for each sector

Period	Banking	Industrial	Cement	Service	Electricity	Agricultural
1986	*-18%*	*-14%*	*-17%*	*-10%*	0%	7%
1987	48%	38%	*-5%*	13%	16%	28%
1988	50%	52%	19%	*-8%*	*-18%*	2%
1989	74%	14%	39%	*-5%*	*-15%*	*-5%*
1990	*-13%*	*-12%*	*-4%*	*-6%*	*-6%*	*-10%*
1991	125%	101%	46%	105%	10%	35%
1992	17%	*-10%*	52%	17%	2%	14%
1993	*-1%*	*-14%*	*-8%*	*-10%*	4%	*-29%*
1994	*-38%*	*-14%*	*-26%*	*-30%*	*-25%*	*-30%*
1995	7%	31%	*-4%*	*-22%*	*-10%*	*-10%*
1996	21%	8%	31%	*-3%*	*-1%*	*-10%*
1997	41%	17%	14%	16%	35%	4%
1998	*-22%*	*-37%*	*-38%*	*-21%*	*-19%*	*-23%*
1999	48%	47%	32%	*-2%*	52%	*-9%*
2000	12%	20%	3%	*-3%*	1%	1%
2001	*-2%*	1%	3%	2%	2%	4%
2002	9%	*-10%*	80%	37%	17%	21%
Average	**21.06%**	**12.82%**	**12.76%**	**4.12%**	**2.65%**	***-0.59%***
Standard Deviation	**0.40**	**0.34**	**0.31**	**0.31**	**0.20**	**0.18**

Figures in italic are negative returns.

3.5.3.1 The banking sector

The Netherlands Bank, which is now Al Bank Al Saudi Al Holandi, was the first bank when opened its first branch in the Kingdom in 1926. The National Commercial Bank was established in 1953 to be the first Saudi bank. By the end of 1961, there were 12 commercial banks operating in Saudi Arabia, three of them were Saudi banks with 27 branches and 75% of total deposits. In that time, the total deposits of banks stood at SR 484 million, loans and advances at SR 576 million, and capital and reserves at SR 139 million (Al-Mahmoud, 2000). In 1975, there were ten international commercial banks in the Kingdom with twenty-three branches. These foreign banks were functioning according to policies drawn up by their parent banks. Therefore, the Saudi government

introduced the Saudisation of foreign owned banks operating in the Kingdom. These were to be formed into joint stock companies with 60% of their ownership being transferred to Saudi nationals (Abdeen and Shook, 1984).

Now, there are 11 banks in the kingdom and the Saudi banking market is the largest in the region with a total of 1,202 branches and capital worth SR 43.3 billion, achieving a 2.3% growth by the end of October 2002. Commercial banks in the Kingdom handle traditional deposit taking and lending, foreign exchange services, inter-bank deposits, and government debt and equity. The banking sector is currently undergoing a restructuring and consolidation campaign. The United Saudi Bank, which was formed out of a merger between the Saudi Cairo Bank and the United Saudi Commercial Bank in 1997, merged with the Saudi American Bank in 1999.

It is obvious from the previous tables (Tables 3-3, 3-4, 3-5, 3-6, and 3-8) that the banking sector in the Kingdom has soared. In 2002, the value of the banking index was SR 25,961,367,000 from just SR 181,848,000 in 1985. Despite being a fluctuating sector, banking had a 21.06% average return, which was the highest average return (Table 3-8) among all sectors, and was the only one of two sectors that had higher average returns than the market. However, Table 3-8 also demonstrates that the banking sector is the most volatile sector in the SSM with a standard deviation of 0.40.

Finally, the Saudi government has depended on local banks to finance the budget deficit. Therefore, local banks had liquidity problems because the loans they provide to the government are long term and most of their deposits are short-term. Table 3-9 shows the banks' claims on the private and public sectors and the total deposits from the period of

1988 to 2002. Table 3-9 illustrates that the banks' claims on both the private and public sectors increased dramatically in that period.

Table 3-9 Banks' claims on the private and public sectors and total deposit (millions SR)

Period	Private sector	Public sector	Total Deposits
1988	70,523	N/A	142,473
1989	73,281	N/A	146,304
1990	65,295	N/A	143,662
1991	73,616	N/A	171,223
1992	86,608	N/A	174,880
1993	101,932	66,063	184,178
1994	113,192	76,960	188,282
1995	121,153	76,734	196,974
1996	123,547	81,969	215,463
1997	133,684	104,070	226,175
1998	160,655	112,965	237,043
1999	162,189	116,613	246,085
2000	172,238	124,712	263,612
2001	187,064	134,650	281,125
2002	205,829	150,610	328,270

Source: Saudi Arabia Monetary Agency, Riyadh, Saudi Arabia, 2003

3.5.3.2 The agricultural sector

One of the main policies of Saudi Arabia is food security and the reduction of food imports. The government has always emphasised the importance of developing the agricultural sector. However, Saudi Arabia has a serious natural limitation, namely water. To counter such a limitation, the government has embarked on an ambitious programme to improve water supplies. The aim was to raise production and to try and achieve self-sufficiency in most agricultural products. As a result, budget allocations to the agricultural sector have increased considerably. In the Third Five-Year Plan, spending

was projected at SR 7,975 million. This increased to SR 14,411 million in the Fifth Five-Year Plan.

In addition to the lack of water, labour is another serious constraint on Saudi agriculture. The population is attracted by urban development, leaving the majority of agriculture work to expatriates. The government is trying to counter this by improving rural life.

Because of the above two limitations, it seems that the solution to Saudi agricultural problem lies in capital-intensive and large-scale farming. This kind of farming is highly mechanised and thus requires only a small workforce.

Saudi Arabian agriculture grew rapidly in the decade to 1995 as the Saudi government sought self-sufficiency in many agricultural products. However, production was aided significantly by government subsidies and suffered when the government reduced its subsidies between 1993 and 1995. Subsidies have continued to decline since then and the agricultural component of GDP has remained steady at between $8 and $9 billion, or 5.3% of 2000 GDP. The Kingdom is self-sufficient in wheat, dates, and eggs and supplies a high proportion of domestic demand for other grains, vegetables, milk and dairy products, fruit, and broiler chickens. However, Saudi Arabia still remains the largest food importer in the Middle East, importing $5.4 billion in foodstuffs in 2000.

From 1985 to 2002, this sector has been continuously fluctuating. According to Table 3-8, the agricultural sector was the lowest compared to other sectors and it was the only one with a negative return, of -0.59%. Nevertheless, Table 3-8 also reveals that the

agricultural sector is the least volatile sector in the SSM with a standard deviation of 0.18.

3.5.3.3 The industrial sector

As has been pointed out earlier in this chapter, some of the existing literature confirmed that firms working in the industrial sector are more probably to seek public equity. Generally, the development of Saudi Arabia's industrial sector is one of most important objectives of the Kingdom's five-year plans. The strategy is aimed at promoting heavy industry in the public sector, almost entirely concentrated in the 70% government-owned Saudi Basic Industries Corporation (SABIC). SABIC is the largest publicly-listed company in the Middle East and one of the top 25 chemical companies in the world. It currently produces basic and intermediate chemicals, polymer resins and polyesters, fertilisers, metals, and industrial gases.

Besides SABIC, there are 25 publicly traded companies in this sector, which make it the largest in terms of the number of share transactions. The industrial sector has been relatively unstable with negative returns seven times between 1986 and 2002. The general economic situation played an important role in causing these negative returns. For instance, the negative return in 1990 was because of the second Gulf War, the negative return in 1998 was because of the drop in oil prices. Nonetheless, the average return of the industrial sector was 12.82% matching the average market return.

3.5.3.4 The cement sector

The history of cement companies goes back to the early 1970s. Cement firms were among the first joint stock companies in the Kingdom. The government and the private sector have relied heavily on these companies to provide necessary constructional materials.

The construction sector has been a major force, accounting for approximately 9.3% of GDP in 1998. However, the construction sector's contribution to GDP had decreased to 7.9% by 2000. This is because the government's role in the economy is reduced. The construction industry is now dependent increasingly on the private sector and quasi-governmental companies to generate new projects. The eight cement firms that make up this sector are discussing possible mergers to protect themselves from the construction slowdown.

Having a 12.76% average return, the cement sector achieved positive average returns in the period from 1986 to 2002. Having negative returns six times, the cement sector was unstable relative to the general market, and most of the negative returns occurred in the years of 1990, 1994, 1995, and 1998.

3.5.3.5 The service sector

The service sector consists of 18 joint stock firms, which make it the second largest sector in terms of the number of firms operating. In addition, the service sector has the highest number of shares in the SSM.

After the second Gulf War, there was an economic boom in the Kingdom, helping the service sector to witness the highest jump in 1991 when its index increased by 102%. Having negative returns 11 times, the service sector fluctuated the most over the period of 1986 to 2002. This sector underperformed the market with just a 4.12% average return.

3.5.3.6 The electricity sector

There were 10 publicly traded companies in this sector. Electricity companies were suffering from high levels of debts, with operating losses resulting from electricity prices that are lower than production costs on the one hand, and low rates of revenue collection on the other. This condition has limited the ability of the electricity companies to finance their capital programmes, particularly in drawing on the capital markets for their investment needs. Trying to solve the problem, Saudi government merged these 10 firms into the Saudi Electricity Company (SEC). SEC is a unified, national company, 85% owned by the government.

According to Table 3-8, this sector was unstable with negative returns seven times. Having a 2.65% average return, the electricity sector has underperformed the market. This sector witnessed its highest jump in 1999 when the index escalated by 52%, when the government announced the plan to merge all the electricity firms operating in the Kingdom.

3.5.3.7 The telecommunication sector

This sector was founded in early 2003 when the Saudi government privatised 30% of the capital of the Saudi Telecommunications Company (STC). 90 million ordinary shares

were sold at an offer price of SR 170. The telecommunication sector has now one company, the Saudi Telecommunication Company (STC). Currently, the STC has exclusive rights to provide telecommunication services in the Kingdom. However, market liberalisation is due to take place in accordance with the Telecommunications Regulations. Partial liberalisation of mobile telephony is scheduled to occur in the last quarter of 2004 and landline telephony by 2008.

Finally, as have been shown, the JSCs in the SSM are classified into seven major sectors. This classification was established a long time ago, when there were few JSCs, and the main activities of JSCs were similar in each sector.

However, with the increase in the number of JSCs in the SSM in recent years, and the expected increase in the future, policymakers should restructure these sectors by relocating some companies and creating new sectors, especially those JSCs classified in the industrial and service sectors (which are the largest two sectors, in terms of the number of companies). For example, they could create new sectors such as transport, real estate, and a petrochemical sector.

3.6 The performance of the JSCs

Some Saudi academics and businesspersons believe that the level of JSCs performance would have a strongly effect on the rate of going public in Saudi Arabia (Al-Awaifi and Al-Aali, 2002). They think that if the performance of the JSCs is high that would encourage more firms to think about listing in the SSM, and vice versa. Table 3-10 illustrates the performance of joint stock companies listed on the Saudi Stock Market.

Apart from companies working in the banking and cement sectors, several companies have negative returns on their assets ratio and many others have low performance. It will be shown in Chapter 8 that this poor performance has contributed the most to reducing the rate of IPOs and making decision makers in private companies reluctant to make an IPO. Some observers attribute this low performance to many factors, such as harsh and destructive competition from local and overseas companies, the lack of managerial and labour skills and financial supplies (Riyadh Chamber of Commerce and Industry, 1994). Others attribute this low performance to the reduction of government expenditure in the 1990s, since the government is the main customer for many companies in the market.

Table 3-10 The performance of listed companies in SSM (the ROA Ratio)

Companies	Years				
	1997	1998	1999	2000	2001
Banking Sector					
Riyad Bank	1.68%	1.71%	1.71%	1.86%	2.01%
Bank Al Jazira	0.43%	0.53%	0.74%	1.01%	1.12%
The Saudi Investment Bank	1.48%	1.82%	1.79%	2.03%	1.99%
Saudi Hollandi Bank	1.15%	1.32%	1.54%	1.87%	1.96%
Banque Saudi Fransi	1.28%	1.51%	1.60%	1.72%	2.11%
The Saudi British Bank	1.53%	1.58%	1.75%	1.71%	1.98%
Arab National Bank	1.44%	0.87%	0.92%	1.08%	1.20%
Saudi American Bank	2.28%	2.38%	1.17%	2.52%	2.91%
Al Rajhi Banking & Investment Corp.	3.80%	3.81%	3.59%	3.90%	2.98%
Industrial Sector					
Saudi Basic Industries Corp.	6.56%	2.37%	2.11%	4.07%	1.99%
Saudi Arabian Fertilizers Co.	9.69%	3.71%	*-0.02%*	5.70%	5.72%
Saudi Arabian Refineries Co.	11.42%	7.95%	6.14%	6.27%	5.47%
Saudi Ceramic Co.	0.21%	*-3.35%*	0.00%	0.53%	*-2.41%*
Savola Group	4.63%	3.77%	5.94%	3.40%	4.28%
National Industrialization Co.	0.16%	3.26%	2.67%	2.59%	2.16%
Saudi Pharm. Indus. & Med. Appliances Co.	3.16%	3.58%	3.94%	3.96%	4.43%
National Gas & Industrialization Co.	4.36%	4.67%	6.76%	10.93%	10.09%
National Gypsum Co.	13.90%	11.72%	12.50%	15.31%	18.56%
Food Products Co.	*-4.48%*	*-6.54%*	*-0.71%*	*-1.70%*	*-3.16%*
Saudi Cable Co.	*-2.56%*	*-1.56%*	0.93%	1.22%	0.08%
Saudi Advanced Industries Co.	-28.20%	0.85%	1.85%	6.83%	3.59%
Saudi Indus. Development Co.	3.25%	0.03%	*-3.40%*	*-5.78%*	*-5.32%*
Al Ahsa Development Co.	3.55%	3.10%	2.23%	2.55%	1.76%
The National Co. for Glass Ind.	*-4.88%*	*-12.36%*	*-4.45%*	2.21%	3.31%

Table 3-10 Continued					
Saudi Arabian Amiantit Co.	5.51%	6.59%	8.92%	8.40%	6.69%
Alujain Corporation	0.19%	*-4.00%*	*-2.77%*	*-12.54%*	*-17.33%*
Filling & Packing Materials Mfg. Co.	3.92%	7.80%	5.02%	4.87%	7.05%
Saudi Industrial Services Co.	2.11%	2.31%	1.54%	*-0.42%*	0.87%
Arabian Pipe Company	1.12%	1.31%	2.21%	*-0.63%*	*-0.70%*
Arabian Industrial Development Company	1.29%	1.01%	1.27%	*-0.11%*	*-4.57%*
National Metal Manufacturing & Casting Co.	*-3.04%*	3.73%	*-1.12%*	*-1.45%*	*-1.75%*
Saudi Chemical Co.	N/A	16.58%	23.82%	5.90%	5.71%
Zamil Industrial Investment Co.	N/A	10.00%	9.75%	2.42%	1.25%
Cement Sector					
Arabian Cement Co. Ltd.	10.59%	6.11%	6.71%	6.82%	10.01%
Yamamah Saudi Cement Co. Ltd.	18.67%	21.57%	18.04%	18.96%	21.38%
Saudi Cement Co.	14.36%	11.45%	10.91%	8.42%	10.71%
The Qassim Cement Co.	18.21%	17.63%	17.65%	17.59%	20.77%
Southern Province Cement Co.	13.61%	11.68%	12.08%	12.97%	19.52%
Yanbu Cement Co.	7.69%	8.01%	5.87%	7.71%	11.20%
Eastern Province Cement Co.	15.13%	13.80%	11.01%	11.44%	15.83%
Tabouk Cement Co.	0.88%	0.21%	0.08%	1.86%	4.76%
Service Sector					
Saudi Hotels & Resort Areas Co.	3.02%	2.83%	3.12%	2.10%	1.91%
Saudi Real Estate Co.	3.84%	4.36%	4.30%	4.22%	6.32%
The National Shipping Co. of Saudi Arabia	0.13%	0.61%	*-3.94%*	*-0.99%*	*-2.96%*
Saudi Public Transport Co.	5.08%	3.73%	1.58%	1.82%	2.35%
Saudi Automotive Services Co.	*-1.30%*	*-3.50%*	*-1.62%*	1.66%	2.22%
Al Mawashi Al Mukairish United Co.	1.41%	*-2.93%*	*-6.82%*	*-5.85%*	0.20%
Tihama Advt. & Pub. Relations Co.	*-3.73%*	1.06%	*-6.12%*	12.78%	5.99%
Assir Trading, Tourism & Manufacturing Co.	5.08%	1.61%	1.28%	*-4.62%*	1.45%
Taiba Investment & Real Estate Dev. Co.	2.34%	1.01%	3.17%	2.65%	2.80%
Makkah Constr. & Development Co.	17.55%	13.32%	5.77%	5.48%	5.90%
Saudi Land Transport Co.	*-1.37%*	*-1.01%*	*-4.17%*	*-24.77%*	*-7.40%*
Al Baha for Development & Investment Co.	0.71%	0.68%	1.28%	*-5.47%*	*-3.62%*
Saudi Industrial Export Co.	4.73%	0.26%	7.75%	2.58%	4.13%
Arriyadh Development Co.	2.09%	2.30%	1.12%	3.46%	1.15%
National Agr. Marketing Co.	1.50%	*-14.52%*	*-2.03%*	6.47%	3.12%
Tourism Enterprises Co. (SHAMS)	*-0.50%*	0.65%	*-0.35%*	*-1.60%*	0.96%
Ahmed Hasan Fitaihi & Co.	4.67%	1.10%	2.24%	0.95%	2.80%
Saudi Telecom Company	N/A	N/A	7.74%	11.20%	5.24%
Electricity Sector					
Saudi Electricity Company	N/A	N/A	N/A	N/A	0.78%
Agricultural Sector					
National Agricultural Development Co.	1.21%	0.95%	1.43%	*-1.39%*	*-1.42%*
Gassim Agricultural Co.	*-14.95%*	*-7.82%*	*-7.16%*	*-6.88%*	0.74%
Hail Agricultural Development Co.	0.84%	*-7.04%*	1.77%	2.17%	1.43%
Tabouk Agricultural Development Co.	4.88%	2.58%	0.78%	1.56%	3.27%
Saudi Fisheries Co.	0.12%	*-6.75%*	*-20.23%*	4.41%	2.41%
Ash Sharqiyah Agricultural Development Co.	*-1.59%*	*-1.16%*	*-0.53%*	*-14.41%*	0.03%
Al Jouf Agricultural Development Co.	5.88%	5.50%	4.87%	1.91%	1.27%
Beshah Agricultural Development Co.	*-12.37%*	*-6.82%*	*-7.06%*	*-6.92%*	*-6.96%*
Jazan Agricultural Development Co.	0.08%	*-1.35%*	*-0.19%*	*-0.54%*	*-3.63%*

Figures in italic are negative returns. Source: Bakheet Financial Advisors, (2003), Riyadh, Saudi Arabia.

3.7 The participants in the SSM

Participants in the SSM can be classified as follows (Al-Razeen 1999):

1. Intermediaries. These include commercial Saudi banks authorised to participate in the SSM on behalf of their customers
2. Joint stock companies, which issue shares
3. Individual and institutional investors who trade in the stock market
4. Financial analysts who analyse financial information and advise their clients about different investment opportunities

The regulations have just changed to allow non-Saudi citizens to trade in the SSM. The leaders of Gulf Co-operation Council (GCC) decided in 1994 to permit GCC citizens to participate in the stock market of GCC countries. The participants can own up to 25% of the shares of joint stock companies registered in GCC countries. Moreover, as mentioned in the last chapter, the government, in 1999, has gone through a reform programme that allows non-Saudi citizens to invest in the SSM through special funds established and controlled by local commercial banks.

Some critics see this step as not enough. They argue that a stock market liberalisation, allowing foreigners to purchase domestic stocks, is a specific element of capital account liberalisation as it removes restrictions on capital inflows, and also typically on capital outflows (e.g., repatriation of dividends or investment returns). Thus, a stock market liberalisation is a particular type of policy that may help to promote financial and economic development. Furthermore, stock market liberalisation may also improve corporate control. By allowing foreigners to buy domestic stocks, international scrutiny

and performance pressure rise. This should directly or indirectly increase the quality, pricing, and availability of products and services (Edison *et al*, 2002).

At last, allowing international investors to participate in the SSM would surely enhance the SSM liquidity, thus, making private companies to think seriously about the option of floating their companies.

3.8 The characteristics of the SSM

The stock market can be characterised by the following attributes (Al-Mubarak, 1997):

- There are no underwriters in the Saudi Market. If there were underwriters, they could help to facilitate the process of issuing new local shares and also provide financial advice. Underwriters also would help to price the securities being offered, structure the transaction, ensure the integrity of its disclosure by doing due diligence on the company, and describe the company so that investors understand why it is attractive. Furthermore, the existence of underwriters is considered to be one of the key elements to attract national savings to invest in productive projects, which would create a sound potential to expand the establishment of more joint stock companies (Chamber of Commerce and Industry, 1994).
- The regulations in Saudi Arabia allow Saudi citizen to participate freely in the SSM, Gulf Co-operation Council (GCC) citizens to own a limited number of shares, and non-Saudi citizen to invest in the SSM through special funds established by commercial banks. These rules diminish the span of activity of the

market and can deprive the Saudi market of an expected large demand for the shares of a successful Saudi company.

- Many investors favour participating in investment funds managed by commercial banks. These funds give investors several privileges, of which the most important are:

    1. Commercial banks hire well-experienced persons to manage these funds. These professional managers have the ability to take sound advice and make provident decisions.
    2. Reduced investment charges per share (banks are allowed by SAMA to charge a maximum of 1% of the total market value of the shares invested) as the total charges are spread over a large number of shares.
    3. Investment funds are well diversified. This diversification diminishes the level of risk.

- Most of the proportion owned by individuals is concentrated in the hands of a few big investors and the remainder is distributed to a wide cross-section of small investors. The big contributors strive to keep their high contributions so they can control the market by keeping their shares and only buy when conditions are favourable. This kind of attitude, of course, has a negative effect on the performance of the market. The large number of small investors with low savings cannot cope with instability in prices and this may leave them with little choice in deciding whether or not to sell (Chamber of Commerce and Industry, 1994).

- Seasonality of transaction is one of the notable features of the Saudi stock market. Transactions do not follow a fixed pattern and are not of the same level all the year through. There are periods and seasons when the market witnesses more activities and transactions, such as at the end of the fiscal year of the listed firms when dividends are paid. By contrast, there are periods when transactions shrink to their lowest level, such as during the summer season when many investors take their vacations and travel abroad.

3.9 The efficiency of the SSM

The efficient market hypothesis (EMH) can be defined and classified in three categories:

- **Weak-form efficiency**: the type of information being considered in weak-form EMH is restricted only to historical prices. Weak efficiency means that the price of the security reflects all its past price and trading history. Thus, if weak-form EMH is valid, investors are unable to earn consistently abnormal profits by simply observing the historical prices of securities (Fuller and Farrell, 1987; Fabozzi and Modigliani, 1992)
- **Semi strong-form efficiency**: this hypothesis says that share prices reflect all the available historical information and new public announcements. Therefore, abnormal returns could not be obtained be using historical information and public announcements because stock prices have already reacted to these information.
- **Strong-form efficiency**: the market is considered as strongly efficient when the stock prices reflect all public and private information (inside information).

Therefore, no investors could ever earn consistently abnormal returns; even an insider could not trade profitably from inside knowledge.

The SSM is really small relatively to other markets in developed countries. Thus, the inefficiency in SSM is more likely because of the small number of analysts and portfolio managers who monitor stocks in the market. Several studies tested the efficiency of the SSM. From the below studies, it is obvious that the SSM is considered an inefficient market. These studies are summarised as follows:

- Alkholifey (2000) used a number of empirical tests, namely the autocorrelation test, the runs test, the filter technique, and a more modern approach, the cointegration test, to examine the efficiency of the SSM. Results of these tests revealed that the SSM is not informationally efficient. He suggested that if the SSM was efficient, that would attract more investors and companies into the market.
- Al-Razeen (1997) examined the efficiency of the SSM by applying the weak-form test of the efficient market hypothesis. He examined the prices over a four-year period from 1992 to 1995. This weak-form evidence indicated that the SSM has a low level of efficiency.
- Attia (1993) studied the economic and development efficiency of the Saudi stock market. The result was that neither from an economic point of view nor from a development point of view is the SSM efficient.
- Abdulsalam and Satin (1991) conducted a study focused on the effect of published corporate financial reports on stock trading volume in the SSM. They

found that the release of earnings information has little effect on the trading volume and on share prices. Therefore, they concluded that the SSM is not efficient

- Felemban (1989) used data for 28 listed companies to test the efficiency of the SSM. He found that "*the SSM in general is considered as an inefficient market*"

It is worth mentioning here that insider trading is considered to be one of the main problems of the SSM. Although, it is against the law to buy or sell stock on the basis of inside information in the Kingdom, insider trading occurs in the SSM frequently, and nobody has ever been prosecuted. SAMA, responsible for monitoring and controlling the daily SSM transactions, does not take serious steps to stop insider trading. Therefore, it is clear that the existing methods of enforcing prohibition against insider trading need serious reassessment.

The authorities could increase the efficiency of the SSM. Firstly, by enforcing more effectively the current laws, and by issuing new laws requesting Saudi JSCs to disclose the necessary information to all the public at the same time. Secondly, the privatisation programme could be accelerated. Thirdly, JSCs could be requested to disclose the name of the top shareholders. Fourthly, liquidity could be increased by liberalising the market, and fifthly, anyone who reveals such important information to particular groups of people should be prosecuted. Finally, once the efficiency of the SSM improved, the trust of both investors and private companies would increased, which could lead to more IPOs (Al-Watan, 2002).

3.10 Summary

This chapter presented the most essential issues relate to the SSM and discussed their possible effects on the IPO activities in the country. The important roles and responsibilities of the Saudi Arabian Monetary Agency (SAMA) were reviewed. To reduce the conflict between the SAMA and the Ministry of Commerce and increase the trust and confidence of investors and private companies, the authorities have to establish a single agency for monitoring and controlling the SSM.

Then, the development of the SSM in term of primary and secondary markets was presented. The cases of privatisation and IPOs that have happened in the Kingdom were reviewed. The government has privatised two companies, so far, and from the late 1980s to 2004 there were just ten companies that went public in the Kingdom.

In addition, this chapter also discussed the share negotiation system and the electronic securities information system. Because the performance of the SSM could affect significantly the rate of going public, the performance of SSM was investigated and also the percentage changes in the price indexes for each sector were analysed to find out the performance of these sectors. The calculation of the SSM price index was presented. The effect of the 10 largest companies listed in the SSM on the general index should be reduced, either by accelerating the privatisation programme or by changing the method of calculating the general index.

Moreover, the performance of all companies listed in the SSM was also examined. Some blame the general economic situation for the low performance of many JSCs, however,

others blame poor management for that performance. This section also showed that there is a belief that the low performance of many JSCs discourages private companies to float their shares.

Furthermore, the participants in the SSM were presented. This section discussed that the Saudi authorities need to increase the liquidity by liberalising the market. Once the SSM is liberalised, the number of investors and market liquidity would increase, which could attract more private companies to the SSM.

Additionally, the characteristics of the SSM were stated. One of the important characteristics of the Saudi Market is that there are no underwriters who could facilitate private firms to seek public equity.

Finally, the efficiency of the SSM was discussed and according to some studies, the SSM is considered inefficient. To boost the investors' and private firms' trust, the efficiency of the SSM should be improved by adopting some steps, such as enforcing more effectively the current laws, and issuing new laws requesting Saudi JSCs to disclose the necessary information to all the public at the same time, and to disclose the name of the top shareholders.

4.1 Introduction

The last two chapters dealt with the development of the Saudi economy and the SSM, as it is believed to be one of the most fundamental factors affecting the development of the IPO market in Saudi Arabia. The IPO market in the Kingdom is very small compared to developed markets such as the UK or USA. The Ministry of Commerce is the responsible agency for granting permission to corporations that are willing to convert to joint stock companies and be listed in the SSM.

The Ministry of Commerce issued the first regulations dealing with the procedures for going public in the Kingdom in 1965, and some regulations were revised in 2000. The clarity of the procedures, the level of the requirements, and the time needed to finish the procedures play a fundamental rule in persuading or discouraging companies from seeking public funds.

A description of the Companies Act, the procedures for going public in Saudi Arabia, and general regulations after a Company has offered its shares, are the main objectives of this chapter.

4.2 The Companies Act

From 1931 to July 1965, companies in the Kingdom operated under the then commercial law. Recognising the need for a new commercial law covering all related matters for firms in the Kingdom, the Saudi government issued a new, comprehensive, and

appropriate law in July 1965. The Saudi government introduced the Companies Act in 1965, becoming the first governmental regulations dealing with a procedure for going public, and accounting and auditing practices (Ministry of Commerce, 1985). The Companies Act was adopted from Egyptian law (Shinawi, 1971)

Before the passage of the Saudi Companies Act, corporations turned to neighbouring Arab countries, especially Egypt, copying certain expedient rules regulating corporations from their formation through their operation to their dissolution (Shinawi, 1971, p. 40).

The Companies Act contains 234 Articles dealing exclusively with the essential details of business formation, such as incorporation, administration, and the Board of Directors. The Companies Act deals also with accounting and auditing practices in general but it does not provide enough details of the necessary requirements. The Act is more specific in the case of auditing than it is on the subject of accounting. It touches on relatively few subjects regarding accounting. The Articles most relevant to the procedures for offering shares to the public, and general regulations after a Company has offered its shares, are discussed later.

4.3 Procedures for going public in Saudi Arabia

There are several methods for offering new shares to the public, summarised as follows:

- **Offer for sale:** offering stock to outside investors by using an offer for sale requires corporations to allocate the new issue of stock to a broker or underwriter. The price of new shares is fixed.

- **Offer by tender:** this method is very similar to the offer for sale method, but with this method, the price of shares is variable (the share price is determined by the market when it is listed on the first day).

- **Offer for subscription:** with this method, corporations sell their shares directly to the public without assistance from a third party. The price of shares here is fixed.

- **Placing:** when a corporation wants to raise capital with less cost and time, it can use this method by placing shares directly with a number of investors who are going to be shareholders of the corporation. In this way, there is no third party involved and the corporation can negotiate with expected new shareholders directly.

Offer for subscription, the direct offer, is the only method that the Saudi Companies Act provides for corporation to offer their shares to the public. However, the law in the country does not prohibit any company from using other methods to offer its shares to the public. Consequently, some companies used the offer for private placement method when they went public, since this method needs less time and money than an offer for subscription. However, companies, wanting to use the private placement method should negotiate with the Ministry of Commerce about how the company is going to place shares directly with a number of investors who are going to be shareholders of the corporation.

According to the Act, the founders, before offering shares to the public, are required to meet four conditions[20].

4.3.1 Authorisation to incorporate

A Royal Decree or ministerial decision has to be issued to the founders, so they can then complete the procedures for formation (Article 52). The company that is willing to be a joint stock company has to have the following characteristics before applying to the Ministry (Ministry of Commerce, 2002):

- The company shall have assets worth SR 50 million ($ 13.3 million) or more and satisfied profits
- The return of equity has to be more than 7% in the last three years and a feasibility study should confirm that this return would be more than 7% in the coming three years
- The company shall have history of operation of five years or more
- If the company uses the subscription method to offer its shares to the public, it shall offer not less than 40% of its shares
- The company shall have a management team capable of managing the company efficiently, protecting its assets, and competing in the market

If the company has these characteristics, it can apply to the Ministry of Commerce. The application has to clarify the following points (Ministry of Commerce, 2002):

- The name of the company, its address, and the year of establishment

[20] All of the Articles in this section and section follows are taken from the Companies Act issued by Ministry of Commerce (1985)

- The top management's salaries, bonuses, contributions in kind, and any special privileges
- Details of financial indicators such as sales, profits, and working capital
- Any lawsuit raised against the company but for which no verdict has been reached
- Details of the potential use of the money raised from the transfer
- Details of the method used to determine the share price, the method of share offering, and the capital
- Details of the percentage of top management's ownership in the company for the last three years, and the potential top management's ownership in the company after the transfer
- Details about any arrangement for unsubscribed shares. The names of people who are willing to take up unsubscribed shares shall be stated

The Ministry requires that companies have to attach the following documents with the application (Ministry of Commerce, 2002):

- A copy of the Memorandum of Association
- A letter showing the approval of the founder for the transfer
- The audited financial statements of the last three years
- A feasibility study prepared by an authorised office in the Kingdom. The study shall clarify the evaluation of the company, the financial statements of the coming three years, the share price, and the method used to determine the price

After the company submits all the required documents, the Ministry of Commerce studies the application to see if the company is eligible to go public. The Ministry decision

depends on the documents submitted and the economic status. After permission has been granted to make an offer, the founders have just thirty days, from the date of the Royal Decree or the Commerce Minister's decision, to offer their shares for public subscription (Article 54).

4.3.2 The prospectus

The prospectus is considered an essential document explaining the corporation's status and objectives. If written inappropriately and untruthfully, it can incur civil and criminal liabilities for the founders. The Act defines the prospectus as an invitation to the public to subscribe in the corporation. According to Article 55, the founders are required to provide particular facts and data in their prospectuses, summarised as follows:

A- **The founders:** The names of all the founders who subscribed to or signed the Memorandum of Association must be stated. Their regular place of domicile, their nationalities, and their occupations must also be revealed.

B- **The corporation:** The name of the corporation has to be chosen by the founders and must not include, in general, the name of a real person. The objectives of the corporation have to be stated. The location of the headquarters should be chosen so that the nationality of the corporation can be determined.

C- **The capital:** The prospectus has to state the amount of paid up capital. SR 10 million ($ 2.7 million) is the minimum of capital of any corporation that want to go public. This disclosure includes a description of:

- The kind of shares to be issued and the number of shares

- The offer price, which includes the share price (Minimum is SR 10 and maximum is SR 50) and the issue charge
- The number of shares taken up by the founders and the number of shares that will be available for public subscription
- Restrictions on the transfer of shares, if any

D- **Contributions in kind:** Details of considerations in kind should be set out. Details include the types of consideration and the value of such considerations.

E- **Dividends:** The policy on dividend distribution that the corporation adopts should be included in the prospectus. This policy may help potential investors to make their decision as to whether to invest in this corporation or not.

F- **Incorporation costs:** The prospectus should contain the amount of money that the founders paid in order to take the company public.

G- **Subscription operation:** The dates set for opening and closing the subscription and the place and terms thereof should be provided.

H- **Allotment:** Arrangements between the Ministry of Commerce and the corporation offering the shares are usually made to decide which method should be applied to allocate shares. The prospectus should state the selected method.

I- **Permission to incorporate:** The prospectus should mention the date of issue and number of the Royal Decree authorising the formation of the company.

J- **Founders' signatures:** The prospectus shall be signed by the founders who have signed the application for authorisation.

4.3.3 Publication of the prospectus

According to Article 55, the aforementioned information to be disclosed by the prospectus has to be published in the Gazette (a newspaper of official record) normally distributed in the area where the head office of the corporation is located.

The publication or advertisement of the prospectus must take place at least five days before the beginning of the subscription operation. In addition, the founder is allowed to publish the prospectus in more than one newspaper but one is enough.

4.3.4 Distribution of the Articles of Association

According to Article 55, the founder is required to make sufficient copies of the company's bylaws. The copies have to be placed at the branches of the banks which are selected to receive applications. The founder has the choice to provide these copies with or without a reasonable charge.

After the publication of the prospectus, subscription lists will be open for a period of not less than ten but not more than ninety days. The company should not be duly incorporated unless all the capital (stock) has been subscribed for (Article 56).

After all the capital has been subscribed, the founders should invite subscribers to a constituent general meeting, to be held in the manner set forth in the company's bylaws, provided that the interval between the date of the invitation and date of the meeting is not less than fifteen days (Article 61). Any subscriber, regardless of the number of his shares, has the right to attend the constituent general meeting. Resolutions at the constituent

general meeting are adopted by absolute majority vote of the shares represented thereat (Article 61). The constituent general meeting shall specifically be competent to do the following (Article 62):

1. Ascertain that the capital has been subscribed for in full and that the minimum capital has been paid up in full in accordance with these Regulations and to the extent of the amount payable on the value of each share.
2. Draw up the final provisions of the company's bylaws. However, the constituent general meeting may not introduce fundamental alterations to the bylaws submitted to it, except with the approval of all the subscribers represented thereat.
3. To appoint the members of the first Board of Directors for a period not exceeding five years and the first auditor, if these have not been appointed in the Memorandum of Association or in the bylaws of the company.
4. To deliberate on the founders' report on the acts and expenses necessitated by the organisation of the company.

The founders should, within fifteen days of the date of conclusion of the constituent general meeting, submit to the Minister of Commerce an application requesting him to announce the incorporation of the company and the following documents should be attached to the said application (Article 63):

1. A statement that the (authorised) capital has been subscribed for in full, showing the amount paid up by subscribers on the value of shares, the names of such subscribers, and the number of shares subscribed for by each.
2. The minutes of the constituent general meeting.

3. The bylaws of the company as approved by the constituent general meeting.
4. The resolutions adopted by the constituent general meeting in respect of the founders' report, the evaluation of contributions in kind and special privileges, and the appointment of the members of the board of directors and the auditor, if such appointment was not made in the Memorandum of Association or bylaws of the company.

The company is considered duly incorporated from the date of issue of the decision of the Minister of Commerce announcing its incorporation (Article 64). The decision of the Minister of Commerce announcing the incorporation of the company should, together with a copy of its Memorandum of Association and bylaws, be published in the Official Gazette at the expense of the company (Article 65).

Finally, it can be seen from the regulation discussed above, that some of the regulations are somewhat ambiguous. Firstly, one of the characteristics that companies want to go public should have is that the company shall have a management team capable of managing the company efficiently, protecting its assets, and competing in the market. This requirement is general and it does not give details of how companies could know if they have a good management team or not. It would be much better if the legislators provided a list of standards which determine the performance of the company's management. Secondly, the regulations do not mention the time needed to complete the procedures in normal circumstances. Thirdly, the regulations require that the prospectus should contain information about the amount of money that the founders paid in order to take the company public. However, the regulations do not specify acceptable cost. For

example, the legislators could regulate that the cost of listing should not exceed 20% of the amount raised.

4.4 General regulations after a Company has offered its shares

4.4.1 The Board of Directors

Articles 66 to 82 of the Companies Act cover all the issues related to the Board of Directors. For example, according to Article 66, a corporation shall be administered by a Board of Directors of three or more. Furthermore, a director must own shares of the company's stock worth not less than SR 10,000 (Article 68). The Board of Directors enjoys full powers in the administration of the company, but it may not contract loans for terms exceeding three years, sell or mortgage the real property or the place of the company business (Article 73). The Board of Directors has the right to specify the manner of remunerating directors, and such remuneration may consist of a specified salary, or of an attendance fee for the meetings, or of material benefits, or of a certain percentage of the profits, or of a combination of two or more of these benefits (Article 74).

4.4.2 Stock

Articles 98 to 111 of the Companies Act discuss regulations related to stock. For instance, according to Article 98, a company's shares should be indivisible as far as the company is concerned. Shares may not be issued at less than par value. But, they may be issued at a premium if the company's bylaws so provide, or if this is approved by a general meeting (Article 98). The shares of the company may be issued either for cash or

for contributions in kind, and share warrants should state the amount paid up on the shares they comprise (Article 99).

Furthermore, cash shares subscribed for by the founders and shares for contributions in kind, as well as the founders' shares should not be negotiable before the publication of the balance sheet and the profit and loss statement for two complete financial years (Article 100). Nevertheless, during the period of suspension title to shares issued for cash may, with due legal provisions for the sale of rights, be transferred from one founder to another or to a director who will submit them as qualification shares, or from the heirs of a deceased founder to a third party (Article 100).

The company may purchase its own shares only in the following cases (Article 105):

1. If the object of the purchase is to redeem the shares.
2. If the object of the purchase is to reduce the capital.
3. If the shares are part of an estate whose assets and liabilities are to be purchased (as a whole) by the company.

The company's bylaws may provide for the distribution to stockholders of a fixed rate (of dividend) not exceeding 5% of the capital for a period of not more than five years from the date of incorporation of the company (Article 106).

Moreover, according to Article 111, the company shall not require any stockholder to pay sums in excess of the amount committed upon the issue of the shares, even if the company's bylaws provide otherwise. Nor may a stockholder recover his interest in the capital of the company.

Finally, the regulations in the Kingdom prohibit insider trading. Top management is forbidden to sell or buy their company stock over short periods, to sell or buy their company stock to affect, directly or indirectly, other investors' decisions, to sell or buy their company stock before any important announcements which might have positive or negative effects on the stock price, and to sell or buy their company stock within ten days of the disclosure of the quarterly reports (Idris, 2002).

4.4.3 Company accounts

According to Article 123, at the end of every financial year the Board of Directors should make an inventory of the value of the company assets and liabilities as of that date and should prepare a balance sheet of the company, a profit and loss statement, and a report on its operations and financial position for the expired financial year, setting out the proposed method for the allocation of net profits.

In classifying the accounts in the balance sheet and profit and loss statement for every financial year, the classification used in previous years should be observed, and the basis of evaluation of assets resolved at the recommendation of the auditor to alter such classification or evaluation basis (Article 124).

In addition, the Board of Directors shall in each year set aside 10% of the net profits to build up a reserve fund to be called the statutory reserve. The regular general meeting may resolve to stop such deduction when the said reserve amounts to one half of the capital (Article 125). This statutory reserve can be used for meeting the company's losses or for increasing its capital (Article 126).

Moreover, the company's bylaws should specify the percentage to be distributed among stockholders out of the net profits (dividends), after deduction of the statutory reserve provided this percentage is not less than 5% of the capital (Article 127).

4.4.4 The auditor

The regular general meeting appoints one or more auditors from among those licensed to operate in the Kingdom and specifies their remuneration and term of office. No person may hold the office of auditor and at the same time take part in organising the company, be a director thereof, or perform any technical or administrative work for the company. In addition, the auditor should not be a partner or an employee of, or be related within four degrees of consanguinity to any founder or director of the company (Article 130).

The auditor has the right of access to the company's books, records, and other documents at any time. The auditor shall be entitled to request such particulars and clarifications as he may deem it necessary to obtain, and to verify the assets and liabilities of the company (Article 131). The auditor must submit a report to the annual general meeting, setting forth the attitude of the company's management in enabling him to obtain the particulars and clarifications requested by him, any violations of the provisions of these Regulations or of the company's bylaws he may have discovered, and the extent in his opinion to which the company's accounts are in conformity with reality (Article 132).

4.4.5 Increase and decrease in the capital of the corporation

The Companies Act gives joint stock companies operating in Saudi Arabia the right to increase their capital if they want. The capital can be increased in the following ways (Article 135):

- Issuing new shares payable in cash
- Issuing new shares against contributions in kind
- Issuing new shares (as fully paid up) against debts of a specific amount due and payable by the company
- Issuing new shares to the amount of the surplus reserve which an extraordinary general meeting resolves to capitalise, or increase the par value of the outstanding shares by the amount of such surplus (reserve)
- Issuing new shares in lieu of founder's shares or outstanding bonds

Stockholders shall have a pre-emptive right to subscribe for new cash shares, unless the company's bylaws provide for their waiver of this right or for its restriction and the reminder of the new shares shall be offered for public subscription, in accordance with the provisions governing subscription for the capital of a company under formation (Article 136).

Regarding the reduction of the capital, an extraordinary general meeting may resolve to reduce the company's capital if it exceeds the company's needs or if the company incurs losses. Reduction of capital may be achieved in one of the following ways (Article 144):

- Refunding a part of the par value per share to the stockholders, or releasing them from liability for all or part of the unpaid amount on such value
- Reducing the par value per share by the equivalent of the amount of the loss incurred by the company
- Cancelling a number of shares equivalent to the amount of the proposed reduction
- Purchasing a number of shares equivalent to the amount of the proposed reduction

4.4.6 The Income Tax and Zakat Law [21]

The first Income Tax and Zakat Law in Saudi Arabia was issued by Royal Decree No. 17/02/28/3321 dated 01/11/1950. Certain rules of this law have been amended since then by several decrees. Moreover, several ministerial decisions, circulars and memos have been issued to interpret the Income Tax and Zakat Law and its application.

The law requires that Zakat is only charged on Saudi individuals, wholly Saudi-owned companies, and the Saudi share of profits of companies owned jointly with foreigners. In addition, the law indicates that those company profits subject to corporation tax are:

1. The net profits realised by any non-Saudi company operating in the Kingdom or operating both inside and outside the Kingdom at any time
2. The earnings applicable to non-Saudi shareholders in the profits of Saudi companies
3. The earnings applicable to non-Saudi sleeping partners in partnerships

[21] Zakat is a religious tax charged in accordance with Islamic law, which this money is given to certain classes of needy people. The fixed rate of Zakat is 2.5%.

Moreover, non-Saudi individual employees are not required to pay income tax in the Kingdom. However, foreign self-employed individuals such as doctors, accountants, lawyers, etc. pay taxes on their net annual income. The tax law does not specify a particular period or the tax year. Hence, it is the choice of the taxpayers to adopt the fiscal years they prefer.

The Saudi government reduced the tax rate imposed on companies in 2000. Table 4-1 shows tax rates applicable to individuals and companies, regardless of company type. From the table, tax rates vary according to the income concerned.

Table 4-1 Income tax rates for non-Saudi individuals and companies before and after 2000

Category	Annual Income (per year)	Tax rate (%) before 2000	Tax rate (%) after 2000
Individuals	First SR 6,000	Exempted	Exempted
	From SR 6,001 - to SR 10,000	5	5
	From SR 10,001 - to SR 20,000	10	10
	From SR 20,001 - to SR 30,000	20	20
	Over SR 30,000	30	30
Companies	First SR 100,000	25	15
	From SR 100,001- to SR 500,000	35	20
	From SR 500,001- to SR 1,000,000	40	25
	Over SR 1,000,000	45	30

Finally, the Saudi government does not force Saudi individuals to pay their Zakat. It is the individuals' responsibility to pay their Zakat to the poor people. Unfortunately, there are many Saudi citizens do not pay their Zakat since there is no penalty. Thus, the Saudi authorities need to adopt a new collection method and persecute any Saudi individuals who do not comply with the Zakat regulations.

4.4.7 Penalties

The Ministry of Commerce is the government body that checks the compliance of companies with the Companies Act. The following shall be liable to imprisonment for a period of not less than three months and not more than one year and/or a fine of not less than SR 5,000 and not more than SR 20,000 (Article 229):

- Anyone who wilfully inserts in the Memorandum of Association, bylaws, prospectus, or other documents of a company, or in the application for authorisation to incorporate it, particulars which are false or contrary to the provisions of these Regulation; and anyone who knowingly signs or distributes such documents.
- Any founder, managers, or director, who invites public subscription for shares of stock in contravention of the provisions of these regulations.
- Those who falsify or do not comply with the mandatory rules. For example, any manager, director, auditor or liquidator will be penalised for disclosing false information in the balance sheet, profit and loss statement, or in the cash flow statement.
- Any one who attempts to conceal the financial position of the company from the partners or third parties by omitting important facts from such reports will be penalised too.
- Any company official who fails to comply with the mandatory requirements issued by the Ministry of Commerce or fails to show the Ministry's representatives such statements and records.

However, the implementations for these penalties are somewhat weak. There are some listed companies who do not publish their financial statements regularly as required and unfortunately the Ministry of Commerce does not take any significant action against them.

4.5 Summary

The objective of this chapter was to present and discuss the Companies Act, the procedures for going public in the Kingdom, and the general regulations of corporations after they have gone public. In doing so, the first section discussed the Companies Act as the first body of regulations to set rules for general requirements of going public. The second section of this Chapter reviewed the requirements that companies have to meet to convert to joint stock corporations. It has been discussed previously that the legislators have to do more to clarify the ambiguity in some regulations and requirements, as clearance of a procedure and the time needed to finish the process play a fundamental role in encouraging firms to make an IPO.

The third section dealt with the general regulations of corporations after they have gone public. The regulations of companies' stock, accounts, auditors, increase and decrease in capital, tax and Zakat system, and penalties were discussed and reviewed. In general, the regulations did not go far enough in satisfying accounting and auditing requirements. There were no exactly prescribed accounting rules or procedures, nor has there been any adequate effort to define the scope and goals of accounting and reporting, or the scope and duties of the audit or auditor. Finally, the government should find an effective method of compelling Saudi individuals to pay their Zakat.

5.1 Introduction

The decision to go public is considered to be one of the most fundamental decisions firms face (Pagano *et al.*, 1998). Companies usually go public via an initial public offering (IPO) of their shares to investors. Companies can sell either newly created or existing shares from an IPO. For new shares, the proceeds from selling these to investors accrue to the company. When existing shares are sold the proceeds obviously accrue to the original investors. In practice, some IPOs consist entirely of new equity, with the original investors retaining their shares. Other IPOs involve selling only existing equity, with no new money being raised for the company, but with the original owners selling some of their shares, and yet others consist of a combination of the two (Jenkinson and Ljungqvist, 2001).

The last three chapters gave a complete review of the Saudi economy, stock market, and procedures for going public in the Kingdom. They explained the possible relations and effects of these components on the IPO activities in Saudi Arabia. However, to completely achieve the objectives of this study, it is necessary to review closely the following specific fields of literature:

- The effect of IPO on companies' performance
- The motivations and benefits of going public
- The barriers and costs of going public

- The effect of an increased number of IPOs on the economy
- The Characteristics of IPOs

Because of the lack of data and studies addressing the above issues in the developing countries in general and in Saudi Arabia in particular, this chapter discusses those issues exclusively according to studies that have been conducted in developed countries. The review of each study covers several variables such as the countries the study has been conducted in, the sample size, the benchmark used, methods used to gather the needed data, the statistical tests adopted, and the main findings and results. This review will facilitate the researcher in this study to determine and develop the best methods could be used to collect the necessary data; to determine the most appropriate statistical tests could be employed to analysis the collected data and; to justify and discuss the findings of this study.

5.2 The performance of IPOs

Degeorge and Zeckhauser (1993) conducted a study in the United States to examine changes in operating performance and ownership of companies that went public. Their sample consisted of reverse leveraged buyouts (LBOs), which went from public to private and returned to the public equity market. The size of their sample was 62 reverse LBOs that moved from private to public between 1983 and 1987. They used operating income after depreciation divided by total assets for their measurement of the operating performance of these companies. Performance improvement was measured as the change in this ratio: [Δ operating income/total assets] (year) = [operating income/total assets] (year) - [operating income/total assets] (year-1). For each reverse LBO, a matched control

firm was chosen by selecting the next firm in alphabetical order in the COMPUSTAT list of firms in the same four-digit Standard Industrial Classification (SIC) category. They used a two-tailed Wilcoxon signed-rank test to measure the significance levels because they hypothesised that the performance of an LBO could be either above or below the benchmark companies

Degeorge and Zeckhauser found strong evidence that the LBOs timed their offer to coincide with strong operating performance. Their operating income as a percentage of total assets grew by about seven percentage points in the pre-issuing year. Comparison with firms in the same SIC category shows a slight decline in the same performance measure. Moreover, in the pre-issuing year, reverse LBOs outperformed continuing LBOs. In the year after going public, however, reverse LBOs disappointed. Their performance worsened significantly in the first public year, falling by about three points, which is ten points below the change in their own previous year and four points below their comparator firms. The net change in performance for the two-year period from the beginning of the pre-issuing to the close of the post-offering year was four percentage points above the norm. They discussed two possible explanations for this pattern of superior performance before the IPO, followed by disappointing performance:

1. Asymmetric information: managers use their private information to time the IPO, and/or manipulate performance,
2. Pure selection: because of debt overhang and behavioural effects, good performers will be more likely to go public than poor performers.

Degeorge and Zeckhauser raised an interesting question about whether the market manages to disentangle the information it receives, and thus to anticipate the disappointing performance in the post-IPO era. If the aftermarket performance of reverse LBO stocks is normal, that would indicate that the market appropriately discounts the effects they describe. If it is below average that would suggest that the market is fooled at the time of the IPO, and only realises its mistake later. Their evidence indicates that the market is not fooled: over the two years following the IPO, reverse LBOs' stocks outperformed comparator firms, although the difference in performance was not statistically significant. Simply, they summarised the decline in profitability as managers timing their issues to coincide with unusually high profitability or engaging in window-dressing of their corporate accounts at the time of the IPO.

It should be noted, however, that Degeorge and Zeckhauser did not test the operating performance of reverse LBOs over a long period, and also did not employ more than one ratio to capture the change in operating performance. Moreover, their findings cannot be generalised since their sample contained only a special type of IPOs, reverse leveraged buyuts (LBOs). Reverse-LBO firms are not representative of a typical firms going public. For example, these companies are not likely to suffer from an acute information asymmetry problem since they were once publicly traded and have relatively longer prior operating history.

Jain and Kini (1994) conducted a study to examine the change in operating performance of companies that switched to public ownership through initial public offerings. Their sample consisted of 682 IPOs that went public in the period 1976 to 1988 in the US

market. Jain and Kini employed two ratios as measures of operating performance. The first measure was operating return on assets, which is operating income before deducting depreciation, interest, taxes, and extraordinary items, divided by end-of-year assets. Operating income equals net sales less cost of goods sold, and selling, general and administrative expenses before depreciation, depletion, and amortisation. The second operating performance measure was operating cash flow, operating income less capital expenditure, deflated by total assets at the end of the fiscal year. They compared the median percentage change of these two measures for the last year pre-IPO and the first three years after the offer. They also measured the median industry-adjusted change in operating performance by matching each IPO firm with firms in the same industry, based on the three-digit Standard Industrial Classification (SIC) codes. The industry-adjusted performance of a firm is the difference between its change in operating performance and the median change in operating performance of all firms in its industry. In addition, all reported significance tests are based on the two-tailed Wilcoxon signed rank tests.

Jain and Kini found evidence that IPO firms show a decrease in post-issue operating performance, as measured by the operating return on assets and operating cash flows deflated by assets, compared to their pre-IPO levels. The decline in operating performance of IPO firms, however, comes with a caveat. These firms have high growth in sales and capital expenditure compared to firms in the same industry in the post-IPO period. Hence, neither lack of sales growth opportunities nor reductions in capital expenditure are the reasons for the declining operating performance of IPOs. They also found that IPO firms have a positive relationship between entrepreneurs' ownership and operating performance (the higher entrepreneurs' ownership, the better the operating

performance). They found no relationship between post-issue changes in operating performance and initial returns at the IPO. The decrease in operating performance after going public is contradicted by the fact that IPO firms are initially priced at high price-earning (P/E) multiples, implying that investors have expectations of higher earning growth in the future. Moreover, IPO companies have, when they start out, high market-to-book (M/B) and P/E ratios compared to their industry counterparts, but experience a decline in these measures after going public. They found also that earnings per share (EPS) decrease with time.

Jain and Kini were able to eliminate the problems in the study by Degeorge and Zeckhauser (1993). Jain and Kini tested the performance of IPOs for long period of time, did not specify their selection on a particular group of IPOs, employed more than one method to test the IPOs performance, and their sample size was large. However, Jain and Kini tested operating performance by operating income and operating cash flow to assets. IPO firms are likely to increase their assets after going public. If that is the case, the IPO sample exceeds the extent of that activity in the industry. In general, this performance measure is biased toward finding poorer performance by IPO firms. An alternative would be to deflate by sales instead of total assets in order to avoid the asset increase problem in the denominator. However, deflation by sales might have the same problem as deflation by assets, since IPOs usually claim that the reason for going public is to expand their market share. Thus, both measures have flaws. In principle, researchers could solve the problem if they have the information on assets that have been put in place for growth. Unfortunately, as outsiders of the firm, researchers do not have access to such

information without using alternative methodology. The case study approach may help with this problem.

McConaughy *et al.* (1995) tested the operating performance of ninety nine IPO firms that went public in 1985 in the USA. They found some difficulties in collecting data for the last two or three years before the IPO. Instead, they began with the IPO-year as the base period. The median of net income on sales, the operating income on sales, and the operating cash flow on sales of their sample were tested to find the change in the operating performance of IPOs. They used the SEC's Registered Offering Securities (ROS) computer tape to identify both the firms that had their IPO in 1985 and those that had their IPO prior to 1980. They selected 1985 IPO firms only if they were firmly committed to common stock offerings. This yielded about 500 firms. Then COMPUSTAT data was used to identify control firms for each 1985 IPO firm. Each match was made on the basis of industry, using SIC codes, and size, within plus or minus 25% of the 1985 IPO firm's sales. They started with the 4-digit SIC code. If no match on size was found, they went to the 3-digit, and if no match was found, they attempted to match at the 2-digit SIC level. If no match was found at the 2-digit level, the 1985 IPO firm was rejected. After a potential size and industry match was found, they used the ROS tape to determine if the matched firm had an IPO prior to 1980. If the potential matched firm went public prior to 1980, it was used as a match. If the firm went public after 1979, it was rejected as a control firm, and the matching process was continued. After this process was completed, there were 99 closely matched pairs of firms at the beginning of the 1985-1992 period.

They believe that their practice of forming matched pairs based on size and industry provided a better basis of comparison than a single industry average adjustment, such as that used by Jain and Kini (1994). IPO firms tend to be smaller; so an industry average would not necessarily reflect the expected performance of the smaller IPO firms if there is any size effect (size will matter in any country if there is economy of scale[22]). To determine if the two groups of firms differed systematically for a given ratio, they used the Wilcoxon signed-rank statistic for matched pairs. They thought this statistical test appropriate because of the skewed nature of accounting data.

McConaughy *et al.* found that profitability declined in the first four years but started to increase after about five years from the IPO. For example, the median operating income on sales was 12.70 in 1985, 7.63 in 1989, and 9.53 in 1991. However, IPO firms were consistently more profitable than the matched firms, though the differences are significant only for 1985 and 1990-92. The profitability for the next four years was not significantly different from the matched firms. The significant increases in 1990-92 are consistent with the operational efficiency results, namely, that earlier investments in assets were beginning to pay off, in terms of net and operating margins, and, perhaps most importantly, cash flow.

It is worth mentioning here that McConaughy *et al.* used the IPO-year as the base period. That allowed them just to test the operating performance after the IPO rather than comparing performance pre- and post-IPO. However, they eliminated the problem that Jain and Kini's (1994) study has, by testing operating performance by operating income

[22] Economy of scale means that reduction in cost per unit resulting from increased production, realized through operational efficiencies. Economies of scale can be accomplished because as production increases, the cost of producing each additional unit falls.

and operating cash flow to assets, by testing net income on sales, the operating income on sales, and the operating cash flow on sales. However, deflation by sales might have the same problem as deflation by assets, since IPOs usually claim that the reason for going public is to expand their market share.

Holthausen and Larcker (1996) examined the accounting and market performance of reverse leveraged buyouts (i.e., firms making their first public offering after previously completing a leveraged buyout). This study, conducted in the United State, provides a detailed examination of the performance and change in organisational structure (leverage and equity ownership) of a sample of 90 LBOs that went public between January 1983 and June 1988.

Holthausen and Larcker measured accounting performance by using two different (although related) accounting ratios widely used in previous studies as measures of performance: the median of operating income, and the median of operating cash flows of the whole sample. They assessed the performance of their sample firms by using three different benchmarks. Firstly, they examined an unadjusted measure, which was simply the performance of the reverse-LBO firm. Secondly, they considered an industry-adjusted performance measure which controlled for time period and industry effects by examining the performance of the reverse-LBO firms after subtracting the contemporaneous median performance of the firms in the two-digit SIC code associated with each reverse-LBO firm. Finally, they examined a mean-reversion-adjusted performance measure which controlled for time period and industry effects as well as for the expected mean reversion

in accounting performance measures when a firm is performing significantly better or worse than its industry.

The mean-reversion-adjusted performance takes the performance of the reverse-LBO firm and subtracts the contemporaneous median performance of all firms in the same two-digit SIC code whose operating assets (operating cash flow assets) are within 10% of the reverse-LBO firm's operating assets (operating cash flow assets) in the year before the IPO (e.g., if the reverse-LBO firm's operating assets are 0.20 in the year before the IPO, the benchmark would be the median operating assets of all firms in the same two-digit SIC code whose operating assets in the same calendar year varied between 0.18 and 0.22). Furthermore, they used cross-sectional regression analysis to capture the relationship between variables.

Holthausen and Larcker found that the accounting performance of reverse LBOs was significantly better than that of the median firms in their industries in the year prior to and in the year of the IPO. Moreover, the reverse-LBO firms continued to perform better than their industries for at least the four full fiscal years after the IPO (though the evidence for the third year is less strong). While these firms continued to outperform their industries, there is also some evidence of a decline in the performance of the reverse-LBO firms subsequent to the IPO, though the strength of this evidence is somewhat dependent on the specific accounting performance metric analysed and the benchmark portfolio used for assessing expected performance.

They found that at the time of the IPO, there was a decrease in the mean leverage ratio and the average equity ownership by insiders (all officers, directors, and employees).

However, equity ownership by managers and other insiders remained concentrated and leverage remained high relative to typical public corporations. Therefore, when these LBOs went public, they were hybrid organisations that retained some of the characteristics of the LBO organisation. Even the leverage and equity moved together. This result indicates that the change in accounting performance (measured from one year before to up to four years after the reverse LBO) is unrelated to the change in leverage and is positively related to the change in the percentage of equity owned by the operational management and other insiders that occurs at the time of the reverse LBO. Specifically, a greater decline in the percentage equity owned by operational management and other insiders is associated with a greater decline in accounting performance. Finally, Holthausen and Larcker's study has the same problem as Degeorge and Zeckhauser's study. They compared operating income to assets and their sample contained only a particular group of IPOs (reverse LBOs).

Cai and Wei (1997) examined 5 years before and 5 years after the IPO the operating performance of 180 IPO firms listed on the Tokyo Stock Exchange during the 1971-1992 period. They used measures of median changes and median levels of ordinary income, operating income and operating cash flow relative to total assets[23]. They defined ordinary income as net sales less cost of sales, selling, general and administrative expenses, and depreciation, plus non-operating income minus expenses, mainly interest income and expenses, before taxes[24]. Operating income was defined as ordinary income plus

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[23] Barber and Lyon (1996) favour the use of operating income because it is a cleaner measure of the productivity of operating assets than earnings. They also suggest that for new issue firms, profitability should be measured relative to net sales since issuing firms show large increases in book assets with no commensurate increases in operating incomes immediately after the issue.

[24] Cai and Wei (1997) think that interest income should be included in ordinary or operating income because many issuers temporarily park some of the proceeds in interest-bearing instruments prior to investing in assets. However, the borrowing policy, adopted by the management, could have a great effect.

depreciation. Operating cash flow was operating income less capital expenditure. Growth rate of capital expenditure was calculated as the growth rate of a 2-year average of annual capital expenditure. A smoothed series of capital expenditure was used to take into account the possibility that large capital expenditure can last over two fiscal years. Earnings are ordinary income before taxes.

They compared the median levels of raw, industry-adjusted median and matching-firms' operating performance for Japanese IPO firms. The matching firm was chosen from the same industry as the issuing firm with the closest ordinary income relative to total assets in year-1 relative to the IPO fiscal year 0. The significance is based on the Wilcoxon signed rank test, which assumes that observations are independent.

Cai and Wei found that Japanese IPO firms exhibited a significant post-issue decline in the operating performance after adjustment for the industry and mean-reversion trends. The post-issue decline was accompanied by a decrease in the shareholdings of corporate directors. Unlike Jain and Kini (1994), however, they found the difference in the decline of profitability between firms with low or high levels of director ownership was not significant. Cross-sectional regressions also indicated that the change in profitability from before to after the offering was not related to either the levels or the changes in the ownership variables. They interpreted the evidence as being more consistent with the windows of opportunity[25] explanation for the new issue puzzle by Loughran and Ritter (1995).

[25] 'Windows of opportunity' means that owners issue new shares when in their opinion their companies are substantially overvalued.

The distinguishing feature of the Cai and Wei study is the testing of operating performance for longer periods (five years before and after the IPO). However, Cai and Wei included financial charges in the operating income, which means that it could be argued that the borrowing policy adopted by the management could have a great effect on that measure. In addition, some researchers, such as Pagano *et al.* (1998), found that IPOs used the money raised to pay off their debt, and the interest rate that IPOs were charged become lower after going public.

Mikkelson *et al.* (1997) studied the relationship between the change in the ownership of common stock and the operating performance of companies that go public. They documented ownership characteristics and operating performance for a sample of 283 initial public offerings by U.S. companies in the years 1980-1983. They analysed operating performance from the fiscal year before the initial public offering to ten fiscal years after the offering. Their primary measure of operating performance was operating income before deducting depreciation, interest, taxes, and extraordinary items, divided by end-of-year assets. This scaling converts operating income into an operating return on assets and allows them to make comparisons over time and across firms. They believed that IPOs typically increase assets substantially, which potentially imparts a downward bias to measures of operating income scaled by asset. Therefore, they also examined operating income scaled by sales. They adjusted each firm's operating return on assets by subtracting the median contemporaneous operating return of a group of matched publicly traded firms.

They employed three different methods for matching. Firstly, the matched companies according to the four-digit SIC industry classification of the company going public. Secondly, matches were made on the basis of industry and size. Companies were matched based on the book value of assets after the IPO, along with the four-digit SIC classification. Finally, matches on the basis of industry and performance were made. Companies were matched based on the level of operating return on assets or sales in the fiscal year prior to going public, along with the four-digit SIC classification.

Mikkelson *et al.* reported that operating income scaled by assets or by sales exceeded the performance of matched publicly traded firms before going public, and then after going public declined to a level below the performance of matched firms. They applied multivariate regression to test the relationship between the decline in operating performance and the changes in ownership structure of IPOs. They found that the operating performance of firms that go public is unrelated to the prior change in or the level of post-offer ownership stakes of officers and directors. However, they found a relationship between operating performance and the sale of shares in the initial public offering by current holders. Therefore, they believed that this decline reflected insiders' decisions to sell shares following favourable performance, rather than the consequences of changes in ownership.

The study by Mikkelson *et al.* has several advantages that other studies do not. Firstly, their sample size was quite large. Secondly, their measures of operating income were scaled by asset and by sales. Thirdly, they employed three different methods for

matching. However, their study has one weak point, which is that they only tested the pre-IPO performance for just one year.

Pagano *et al.* (1998) investigated the determinants of IPOs by comparing the *ex ante* and *ex post* characteristics of IPOs with those of private firms. Their sample contained 69 non-financial Italian firms that went public between 1982 and 1992.

Pagano *et al.* measured operating performance by dividing EBITDA (earnings before interest, taxes, depreciation, and amortisation) over total assets at the end of the previous year. They documented that operating performance decreased after going public making the explanation based on mispricing windows of opportunity appear more appropriate. However, they just employed operating return on assets as the sole measure to test the profitability of these firms, and they did not match their results against any benchmark.

Kutsuna *et al.* (2002) examined the operating performance of Japan Securities Dealers Association Quotation (JASDAQ) companies. They gathered data for 247 IPOs that went public from 1995 to 1996. Kutsuna *et al.* tested the operating performance from five fiscal years before the IPO (Year -5, -4, -3, -2, and -1) to four years after the IPO (Year 0, +1, +2, and +3) and employed three measures of operating performance stated below:

1. Net sales, ordinary profits, and net profits for each year;
2. Ordinary profits and net profits divided by end-of-year net sales to control for variation in sales revenue;
3. The growth rates of net sales, ordinary profits, and net profits were explored, adjusting the operating performance by the industry median.

Kutsuna *et al.* examined both raw and industry median–adjusted operating performance. The industry median-adjusted operating performance was calculated as the difference between the raw ratio of ordinary profits to net sales and the median ratio of all JASDAQ-registered firms in that industry.

Kutsuna *et al.* documented a sharp decline in operating performance after flotation. They analysed the relationship between ownership structure and operating performance before and after IPO by estimating cross-sectional OLS (Ordinary Least Squares) regressions. They found that the decease in operating performance was due to the change in ownership structure of IPOs. Despite the many strong points of this study, the result could have been strengthened if Kutsuna *et al.* had used other performance measures, such as operating performance per capita or per assets, or stock performance.

Kim *et al.* (2004) conducted the first study to test the operating performance of IPOs in emerging market (to the best of the researcher's knowledge). They examined 133 Thai firms that went public during 1987-1993. Kim *et al.* (2004) used two measures to find the operating performance of IPOs. They use the median percentage change of operating income on total assets and the median percentage change of operating cash flow on total assets. They tested IPO-firms' operating performance over time, as well as, comparing their performance to the performance of the industry-median, calculated as the change for the IPO firm less the change for the industry-median. To report the change in operating performance over time, they calculated the median difference between the operating performance of each firm during two time points. Specifically, they reported the median change between the operating performance during the year before the IPO (t = -1) to the

IPO year (t = 0), and each of the 3 years after the IPO (t = +1, +2, +3). They used the Wilcoxon signed rank test to examine significance levels.

Kim *et al.* documented a decline in the operating performance of Thai IPOs. For instance, operating income on assets three years after the IPO was 70% lower than during the year before the offerings. They did not find a positive linear relationship between the managerial ownership and the operating performance of IPOs. However, they did model a cubic form of the relationship in IPO firms and found a relationship between the level of managerial ownership and company performance. Their results revealed that, on the one hand, increases in managerial ownership are related with better firm performance within both the 0 - 31% and 71% and above ownership ranges. On the other hand, greater managerial ownership is negatively related to company performance in the 31-71% ownership range. Even Kim *et al.* used EBIT/AT and found that older and growing IPOs have better performance than younger and less growing IPOs. Moreover, they documented that firms with more bank debt had much better operating performance. Finally, the significant contribution of the study by Kim *et al.* is that it is first conducted in an emerging market to test the performance of IPOs. However, findings by Kim *et al.* could be much stronger if they tested the IPO operating performance for more fiscal years prior to the IPO (they tested operating performance for just one fiscal year prior to the IPO)

A summary of the studies discussed here are shown in Table 5-1. Studies from many countries, over different periods and measures support the argument that the operating performance of the IPOs declines after going public. However, even though most of the

studies attribute the decline to the window of opportunity, there is no real consensus on the reasons for this decline.

Finally, reviewing these researches facilitates the researcher in the current study to adopt the most legitimate approaches to measure the performance, and also to determine some possible reasons behind the high or low performance. However, Chapter Six will show that most of these studies obtaining the necessary data from databases and this approach is not feasible in Saudi Arabia.

Table 5-1 Summary of the literature review on the operating performance of IPOs

Study / Country	Operating Performance	Sample Period	Sample Size	Reasons for Change	Measures
Degeorge *et al.* (1993) / USA	Decline	1983-87	62	Window of opportunity	Ordinary I/A, OI/A, & OCF/A
Jain & Kini (1994) / USA	Decline	1976-88	682	Ownership structure	OI/A & OCF/A
McConaughy *et al.* (1995) / USA	Decrease then increase	1985	99	The period between the investments & payoff	OI/A
Holthausen and Larcker (1996) / USA	Increase	1983-88	90	Ownership structure	OI/A & OCF/A
Cai & Wei (1997) / Japan	Decline	1971-92	180	Window of opportunity	Ordinary I/A, OI/A, & OCF/A
Mikkelson *et al.* (1997) / USA	Decline	1980-83	283	Window of opportunity	OI/A & OI/S
Pagano *et al.* (1998) / Italy	Decline	1982-92	69	Window of opportunity	OI/A
Kutsuna *et al.* (2002) / Japan	Decline	1995-96	247	Ownership structure	Ordinary I/S
Kim *et al.* (2004) / Tai	Decline	1987-93	133	Associated with younger & less growing firms	OI/A & OCF/A

5.3 The motivations and benefits of going public

Stakeholders may benefit from the IPO in different ways, discussed below:

5.3.1 Growth

Finding new sources of finance to fund the company's future expansion is believed to be the most common incentive for going public.

Ransley (1984) conducted a survey to find the most important motives making Unlisted Securities Market companies in the U.K. go public. Providing funds for expansion came third, after improving company credibility and improving prospects for growth by acquisition, with 44% of the respondents believing that this first is a very important motive for going public.

Jain and Kini (1994) tested the growth of sales and capital expenditure. Their evidence supports the ideas that IPOs use the money raised to expand their businesses. The results show that:

- the sales of IPOs firms increased by 80.67% more than their counterparts in the same industry over the four years after going public
- The growth in capital expenditure of IPO firms increased over all time windows. For example, the median percentage change in capital expenditure was 167.33% for Year +3 relative to Year -1

The distinguishing feature of Jain and Kini's study is that it tested empirically whether IPOs eventually used the money raised for growth, unlike the previous study which captured the expected motivations.

McConaughy *et al.* (1995) found evidence that firms go public to raise capital for expansion. Their findings showed that the median value of sales jumped from 19.2 in 1985 (year of IPO) to 69.6 million US dollars in 1992. Sales grew at a compound annual rate of 20% for the IPO firms over the seven-year period compared to a 13% compound annual rate for the matched firms. Moreover, the IPO firms had higher one- and two-year

sales growth rates during all periods than the matched firms. For example, the IPO median sales growth from 1987 to 1989 was 25%, but only 17% for the matched firms.

Rydqvist and Högholm (1995) explored the decision to go public. Their sample consisted of 166 Swedish family-owned corporations, which went public between the period 1970-1991. They found that financing growth was the most frequently stated financial motive in 127 prospectuses. 64% of Swedish corporations say they go public to finance growth. However, it should be said here that Rydqvist and Högholm reported the stated reasons for going public, not the real ones. In other words, Rydqvist and Högholm did not mention if the money raised at the time of the IPOs was actually used for more growth.

Holthausen and Larcker (1996) found evidence that prior to the IPO, reverse-LBO firms spend less on capital expenditure than the median firms in their industries, and that subsequent to the IPO, their capital expenditure return to the median level of their industry counterparts. However, Holthausen and Larcker's study tested IPO growth just by capital expenditure. They could have improved their findings if they had used more growth measurements, such as sales growth.

Another study conducted by Cai and Wei (1997) measured the growth patterns of capital expenditure, net sales, and growth rate of operating income. The result showed that the median change and also the median industry-adjusted change of all these measures from year -1 to year +5 were -24.7 and -21.4 for the growth rate of capital expenditure, -7.5 and -4.0 for the growth rate of net sales, and -19.0 and -8.6 for growth rate of operating income. In addition, the median matching-firm-adjusted change for all the growth measures for the same period was -15.6, -1.4, and -3.5 respectively. This evidence

demonstrates that the all growth rates significantly decreased after the offerings. Despite Cai and Wei proving empirically that companies did not grow after the IPO, they did not investigate the reasons which could contribute to the reduction in growth rates.

Pagano *et al.* (1998) measured the growth of capital expenditure and sales. Capital expenditure was 0.023, 0.016, -0.017, -0.041 for year 0, year +1, year +2, and year +3 respectively. Growth of sales was 0.031, 0.029, -0.003, and 0.015 for year 0, year +1, year +2, and year +3 respectively. These numbers show that capital expenditure and sales decreased significantly two years after the IPO. However, Pagano *et al.* in their study did not use a benchmark to compare the change in capital expenditure and sales against.

Kutsuna *et al.* (2002) tested the growth rate of net sales. Their evidence supports the idea that the growth of IPO firms increases after going public. The median sales growth increased from year -1 to year +1 12.85%, and from year -1 to year +3 8.88%. They found that the industry-median-adjusted growth rate of net sales for year -1 to year +1 increased 5.05%, and for year -1 to year +3 increased 2.04%. Although Kutsuna *et al.* compared their results to a legitimate benchmark, they used only one test to explore if companies grew after the IPO.

Kim *et al.* (2004) tested sales growth and capital expenditure. They found that sales of IPOs significantly increased over the four years after the firm went public. The median percentage change of sales from year -1 to year +3 increased 97.12% while the industry median was just 28.10% for the same period. In addition, the median percentage change of capital expenditure from year -1 to year +3 decreased -37.11%. However, the industry

median decreased -52.27% for the same period, making the decline not significant compared to the industry median.

5.3.2 Improving credit rating

Providing more information about their status, joint stock firms have more credit worthiness than private firms.

53% of Ransley's (1984) respondents believed that improving company credibility/status is a very important motive for going public which enables them to negotiate with the capital suppliers for better rates.

Rajan (1992) said that one of the advantages of going public is that access to security markets may reduce the cost of credit, probably due to the company's improved bargaining position with banks.

However, Planell (1995) found some evidence that newly listed Spanish companies faced a comparatively high cost of credit before the IPO, but enjoyed no obvious decline in interest rates after the IPO.

On the other hand, Pagano *et al.* (1998) found that going public enables companies to borrow more cheaply. Around the IPO date, the interest rate on their short-term credit drops and the number of banks willing to lend to IPOs increases. They think there are three reasons why the rate may fall after an IPO. Firstly, reducing their leverage, companies, upon listing, might become safer borrowers. Secondly, IPOs disclose more information, so lenders spend less to gather information about IPOs' creditworthiness.

Thirdly, being listed on the stock market offers the company an outside financing option that curtails the bargaining power of banks (as in Rajan, 1992). However, Pagano *et al.* (1998) could find no evidence to support the three reasons stated above.

5.3.3 Portfolio diversification and liquidity

Because there is no market for the stock of closely held firms, their shares are illiquid. The holders could face some difficulties in raising cash by selling shares. In addition, Pagano *et al.* (1998) said that:

> *"Private companies' shares can be traded only by informal searching for a counterpart with considerable cost for the initiating party and with no established price at which to complete the transaction".*

These problems can be solved once a company is listed on the stock market. Liquidity allows investors to rebalance at low cost. When the firm is widely owned and the shares are publicly traded, the owners can easily change the net investment by trading in the stock market (Rydqvist and Högholm, 1995).

The risk can be reduced by dispersing investments because the fewer types of investment held, the greater the injury if one investment does poorly. Pagano (1993) thinks that diversification is an essential reason for going public because the entrepreneurs face borrowing constraints and lack of liquidity, and thus cannot diversify their portfolios unless they go public. Brealey and Myers (1996) indicated that 50- 70% of the firm's risk can be diversified away and, on average, the risk premium for a well-diversified portfolio

relative to a portfolio of T-bills has been 8.4% during 1926-1994. These two numbers show that investors can reduce risk using diversification.

Original owners of a firm can use diversification to benefit directly and indirectly from the decision to go public. They benefit indirectly when the companies raise fresh equity capital after the IPO and acquire stakes in other companies and they can benefit directly by moving to reinvest in other companies (Pagano *et al.*, 1998). Share trading on an organised exchange is inexpensive, particularly for small shareholders who want to trade at short notice. As a result, if the initial owners raise money from dispersed investors, they factor in the liquidity benefit provided by being listed on an exchange (Pagano *et al.*, 1998).

Ransley (1984) and Jenkinson and Espenlaub (1991) find that around 40% of the money raised in USM flotations in Britain in the 1980s went to the original owners. But, founders are generally considered unwilling to float more than the bare minimum needed to obtain an appropriately liquid market, citing the need to retain control; and only about a quarter of issued equity is sold (Röell, 1996).

Rydqvist and Högholm (1995) reported that over half of IPO owners do not cash in at all. But divestment tends to continue in the years following the IPOs. They found that in Sweden 93% of IPOs make secondary offerings in the five years following going public (original owners reduced the net investment in their own firm to nearly 50% of the previous level).

Brennan and Franks (1997) examined the changes in ownership structure of 69 IPO firms in the UK. They found that, on average, most of the shares owned by pre-offering shareholders were sold at the time of IPO or in subsequent years. They found also that within seven years more than two third of shares of UK main market entrants were sold to outside shareholders.

Cai and Wei (1997) found that the owners of Japanese IPO firms in 1971-1992 sold some of their shares at the time of IPO or in the years following, since the top-10 owners held a median of 57% after the offerings, comparing to 81% pre-offerings.

Mikkelson *et al.* (1997) provided evidence on ownership of equity before and after going public. Their evidence showed that by five and ten years after going public, ownership becomes significantly less concentrated. The largest declines in median ownership stake occurred for the CEO, officers, and directors as a group, and majority stakeholders.

Pagano *et al.* (1998) found that the median percentage stake of voting rights held by the controlling group fell by 30% at the time of the IPO and by 5% more in the three subsequent years. They also found that controlling shareholders do not seem to plan the IPO to diversify their equity holding, ruling out the diversification motive. But the reduction in the riskiness of the controlling group's holdings may still be an important determinant of IPOs, because newly listed companies significantly decrease their leverage with the funds raised at the IPO.

Kutsuna *el al.* (2002) documented the change of ownership structure before and after IPOs. Their data shows that the median stake of the top shareholders was 29.82% before

the offering, and fell by 6.95% points to 22.87% one year after the offering. The median stake of the top 10 shareholders decreased by 16.84%, from 80.54% before the offering, to 63.70% one year after the offering, indicating that shareholders use IPO to diversify their portfolios.

5.3.4 Motivating and monitoring management as well as employees

Going public gives IPOs an opportunity to offer vendors, suppliers, and employees stock or stock options, giving these individuals a stake in the company's success and a reason to act to advance that success (Hare, 1994). If a substantial amount of managers' personal wealth depends on their firms' performance or their compensation is based either directly or indirectly on shareholder profits, managers have the incentive to maximise the firm's value (Schranz, 1993).

33% of the respondents in Ransley (1984) cited an improvement in the morale of management and staff as a major advantage of going public. While this may simply be a natural response to the company's signal of growth intentions, many companies explicitly cite the need to retain and motivate senior management and employees through share participation schemes as a reason for going public. Presumably this cannot be achieved with private equity, because employees do not wish to be at the mercy of the controlling group when they leave the company and want to cash in their stake (Röell, 1996). Instead, as modelled by Holmström and Tirole (1993) and documented by Schipper and Smith (1986), a well-informed stock price is of value in itself as an input into managerial performance-linked compensation, thus reducing agency cost.

Moreover, the stock market provides a managerial discipline device, both by creating the danger of hostile takeovers and by exposing the market's assessment of managerial decisions (Pagano *et al.*, 1998). However, Pagano and Röell (1998) argue that private companies owned by more than one shareholder might be overmonitored. If the scale of a planned expansion is very large, and, therefore, needs to be financed by many investors, the cost of this overmonitoring becomes very large, which it is preferable to going public. Thus, this model predicts a positive correlation between the probability of an IPO and the scale of the subsequent investment (Pagano *et al.*, 1998).

5.3.5 Enhancing company image

Being open to public scrutiny, public companies tend to be better known and are likely to be accepted more easily as trustworthy and dependable. The reputation and visibility they gain as public companies can help them to win customers, secure financing, or expand from a regional company to a national one (Hare, 1994).

Enhanced company image was considered to be a major advantage of going public in Ransley's (1984) survey (cited by 36% of respondents). Going public is believed to be a marketing tool and provides not only an initial certification by financial market professionals but also a longer-term price signal to suppliers, customers, as well as employees. A highly solid financial status in the aftermarket gives assurances not only to suppliers to provide trade credit but also to employees to expect a good job.

Rydqvist and Högholm (1995) document that many IPOs state publicity as an important motivation for going public. For example, "the stock market introduction makes the firm

better known which make it easier to sell the firm's products and to attract qualified personnel".

5.3.6 Investor recognition

The majority of investors own portfolios that consist of a small proportion of existing securities (Pagano *et al.*, 1998). That happens because investors basically ignore that a particular company exists. Going public can help to solve this problem by acting as an advertisement for the company. Merton (1987) introduced this idea in a capital asset pricing model with incomplete information, showing that stock prices are higher the greater the number of investors alerted to a company's securities. This theory finds indirect support in the fact that when companies already listed elsewhere announced their decision to list also in New York, their stock yielded a 5% abnormal return on average (Kadlec and McConnell, 1994). On the other hand, Dharan and Ikenberry (1995) found a post-listing negative drift.

5.3.7 Acquisition

The position of being a publicly traded corporation improves the prospects of growth by acquisition (Ransley, 1984). If the company is seeking growth in this manner, there are often benefits in being able to use marketable securities as part or all of the consideration, as an alternative to funding the acquisitions from internal resources or borrowing the money externally (Ransley, 1984). Moreover, Hare (1994) says that stock transactions can be used to effect acquisitions while conserving cash.

About 7.6% of the companies that went public in the Unlisted Securities Market in the UK wrote in their prospectuses that the first reason for taking their companies public was acquisition and 12.8% of such companies said that acquisition was the second reason for going public (Buckland *et al.*, 1989). Acquisition was a very important motive of going public in Ransley's survey (1984) (cited by 53% of respondents).

5.3.8 Exploiting mispricing

As suggested by the windows of opportunity hypothesis, companies go public when entrepreneurs recognise that other companies in their industry are overvalued. Several empirical studies suggest that companies can time their offers successfully and exploit the overvaluation of their companies by investors. Ritter (1984) and Loughran *et al.* (1994) found that the probability of an IPO is positively affected by the stock market valuation of firms in the same industry. Pagano *et al.* (1998) found, systematically, that more companies go public when the average market-to-book (MB) ratio of public firms in their industry is higher. Therefore, Pagano *et al.* (1998) believe that companies time their decision to go public to take advantage of industry-wide overvaluations.

Lerner (1994) tested 350 privately held venture capital backed biotechnology US firms between 1978 and 1992. Lerner documented that venture capitalists, who specialise in providing funds to privately held firms, take their firms public when they are overvalued by outsiders.

Several explanations have been advanced to explain the relation between stock returns and issuing activity (Rydqvist and Högholm, 1995):

1. Demand for financing may be higher when stock prices are high and the cost of capital low, because there are more projects with positive net present value. This is a variation of the business cycle hypothesis: average firm quality is higher when there are more profitable investment opportunities.
2. Loughran *et al.* (1994) and Spiess and Affleck-Graves (1995) show that stock prices underperform the market index after the firm has made an equity offering. This suggests that managers have the ability to time and exploit temporary overvaluation by selling equity when stock prices are high. This hypothesis applies to both primary and secondary distributions.
3. Ellingsen and Rydqvist (1994) developed the following argument: when stock prices increase, stockholders become wealthier. As a result of decreasing marginal utility, stockholders may want to allocate some of the wealth increase to consumption and diversification, but this means that shares must be sold, which forces the owners of a closely held firm to go public. This hypothesis applies only to secondary distributions.

Rydqvist and Högholm (1995) concluded that going public activity in Sweden took place after an exceptional stock price increase.

5.3.9 Establishing a value for the firm

For a number of reasons, it is often useful to determine a firm's value in the marketplace. For instance, if a company wants to give the incentive of stock options to its employees, it is important to know the appropriate value of those options (Brigham and Gapenshi, 1997). Rydqvist and Högholm (1995) argued that:

"The stock price is a signal of the most likely value of the firm. Since this information is available to everyone, information becomes (more) symmetric which enhances liquidity. So, if liquidity is valued by investors, the market valuation is also valuable. Symmetric information is also valuable if the firm wants to sell additional shares after the IPO. If many shares are offered for sale, the firm may split up the offering into a small IPO followed by a large seasoned public offering (SPO)".

The two-stage offering uses the market valuation after the IPO to reduce adverse selection in the SPO (Ellingsen and Rydqvist, 1994). Consistent with this hypothesis, many issuers in Sweden state in the prospectuses that issuing equity in the future will be easier after the stock market introduction (Rydqvist and Högholm, 1995). Moreover, Holmström and Tirole (1993) suggested that the market valuation can be used to measure managerial performance.

5.3.10 Paying off debt

Companies can use the money raised to pay their debt. Mikkelson *et al.* (1997) documented that United States older firms are more likely to use the funds raised from going public to pay down debt. Pagano *et al.* (1998) also found that Italian companies do not go public to finance subsequent investment and growth, but rather to rebalance their accounts after a period of high investment and growth.

However, Rydqvist and Högholm (1995) documented that the average debt-asset ratio of 166 Swedish IPOs dropped from 0.68 to 0.60 and the drop corresponds exactly to the

new equity raised through the IPO. They concluded that firms, on average, neither increased debt financing nor repurchased debt with the cash received for new shares.

Table 5-2 gives a summary of the main advantages of going public and the studies which explored them. Interestingly, on the one hand, some research supported these advantages, but on the other hand some rejected them. These different opinions might come from differences in the time, the sample size, the model used, the benchmark used, the country, and the economic situation at the time of the study.

Table 5-2 Summary of the literature review on the advantages of going public

Advantage	Supporting Studies	Rejecting Studies
Growth	Ransley (1984), Jain and Kini (1994), McConaughy *et al.* (1995), Rydqvist and Högholm (1995), Holthausen and Larcker (1996), Mikkelson *et al.* (1997), Kutsuna *et al.* (2002), & Kim *et al.* (2004)	Cai and Wei (1997), & Pagano *et al.* (1998)
Improving the Credit Rate	Ransley (1984), Rajan (1992) & Pagano *et al.* (1998)	Planell (1995)
Diversification and Liquidity	Ransley (1984), Jenkinson and Espenlaub (1991), Pagano (1993), Rydqvist and Högholm (1995), Brennan and Franks (1997), Cai and Wei (1997), Mikkelson *et al.* (1997), & Kutsuna *el al* (2002)	Pagano *et al.* (1998)
Motivating & Monitoring Management & Employees	Ransley (1984), Hare (1994), & Schranz (1993)	
Enhanced Company Image and Publicity	Ransley (1984), Rydqvist and Högholm (1995)	
Investor Recognition	Merton (1987), & Kadlec and McConnell, (1994)	Dharan and Ikenberry (1995)
Acquisition	Ransley (1984), Buckland *et al.*, (1989), & Hare (1994)	
Exploiting Mispricing	Ritter (1984), Lerner (1994), Loughran *et al.* (1995), Rydqvist and Högholm (1995), and Pagano *et al.* (1998)	
Establishing a value for the firm	Holmstrom and Tirole (1993), Jegadeeh *et al.* (1993), Rydqvist and Högholm (1995), & Brigham and Gapenshi, (1997)	
Paying the Debt	Mikkelson *et al.* (1997), &Pagano *et al.* (1998)	Rydqvist and Högholm (1995)
Solving the problem of lack of family succession and control		

5.4 The barriers and the costs of going public

Any decision taken has its disadvantages. The following discusses the possible disadvantages and the costs which may occur due to the decision to go public:

5.4.1 Loss of control

As mentioned previously, going public is an opportunity for entrepreneurs to diversify their investments. The founders use an IPO as a step to reach a structure of ownership in the company that will maximise their total proceeds from its eventual sale. By selling a great proportion of their stock, the founders might lose the control of the company and cease to play a significant part. Therefore, the transfer of control is a key factor underlying the decision to go public (Zingales, 1995).

Jain and Kini (1994) documented that, on average, a controlling group retains a comfortable majority of voting right several years after going public. In addition, Rydqvist and Högholm (1995) found that two years before the IPO, insiders hold 90% of the shares. Most firms (83%) are initially closely held (100% retained). Immediately after the introduction, the average ownership retention is reduced to 57% of the shares, and five years later to 36%.

Brennan and Franks (1997) gave evidence that, on average, a large majority of shares owned by pre-IPO shareholders were sold at the IPO or in following years. They also found that these sales derived from those insiders who were not directors of the company. They believed that directors derive benefits of control that are not available to non-directors. However, immediately following the IPO, new shareholders own about 52.4% of the company, with the remainder being split between directors and other old investors.

Rydqvist and Högholm (1995), and Brennan and Franks (1997) concluded that the original owners had actually lost the control because they hold only less than 50% of the

total shares. Nevertheless, it could not be the case since owning less than 50% of the total share could be enough for the original owners to hold a comfortable majority of voting right in the case if the remaining of the ownership is diffused on many parties and is not concentrated on one group.

When Cai and Wei (1997) tested the ownership structure of 180 Japanese IPO Firms, they documented that shareholder dispersion increased significantly, therefore reducing shareholder monitoring of managers. Mikkelson *et al.* (1997) found that the turnover of top managers decreased from 28.1% to 21.4%.

Pagano *et al.* (1998) documented that, three years after going public, the controlling group sold out its controlling stake to an outsider in 13.6% of cases. They concluded that IPOs are followed by an abnormally high turnover in control. Moreover, Kutsuna *et al.* (2002) found that the top 10 shareholders decreased their stake after the IPO, but ownership remained concentrated because they held more than 60%.

5.4.2 Adverse selection

When insiders know more than outsiders about the value of the firm, there is adverse selection in that low quality firms are more likely to be offered for sale. In equilibrium, outside investors protect themselves by reducing the price at which they are willing to buy the shares (Rydqvist and Högholm, 1995).

This informational asymmetry adversely affects the average quality of the companies seeking a new listing, and thus the price at which their shares can be sold (Leland and

Pyle, 1977), and also determines the magnitude of the underpricing needed to sell them (Rock, 1986).

Determining the share prices of recently listed companies is a complex task because most of these firms have little or no operational history, and outside investors have little or no information about the IPOs (Jenkinson and Ljungqvist, 2001).

Chemmanur and Fulghieri (1995) suggested that this adverse selection cost is a greater barrier to the listing of younger and smaller firms because they have less of a track record and lower visibility than for older and larger firms.

Table 5-3 shows a summary of previous studies on the underpricing and long run performance of IPOs. These empirical studies revealed overwhelming international evidence of initial underpricing and underperformance of IPOs in the long run.

Table 5-3 Summary of previous studies on the initial and long run performance returns of IPOs

Country	Study	Sample Period	Sample Size	Initial Return (%)	Long-run Return (%)
Australia	Finn & Higham (1988)	1966-78	93	29.20	-6.52
Australia	How & Low (1993)	1979-89	523	16.10	-------
Australia	Lee, Taylor, and Walter (1996)	1976-89	266	16.41	-51.25
Austria	Aussenegg (1997)	1984-96	67	6.50	-73.90
Australia	Woo (2000)	1990-95	115	12.4	-------
Brazil	Aggarwal *et al.* (1993)	1980-90	62	78.50	-47.00
Canada	Jog & Riding (1987)	1971-83	100	11.00	-------
Canada	Kyzanowski & Rakita (1999)	1993-99	242	7.2	-------
Chile	Aggarwal *et al.* (1993)	1982-90	36	16.30	-23.70
China	Mok & Hui (1998)	1990-93	87	289.2	-------
China	Su & Fleisher (1999)	1987-95	308	948.59	-------
Egypt	Hegazy (1998)	1994-96	32	15	------
Finland	Keloharju (1993)	1984-89	80	8.70	-26.40
France	McDonald & Jacquillat (1974)	1968-71	31	3.03	15.60
France	Jacquillat *et al.* (1978)	1966-74	60	4.09	10.69
France	Husson & Jacquillat (1989)	1983-86	131	4.00	-------
France	Leleux & Paliard (1996)	1983-91	108	14.30	-9.42
Germany	Uhlir (1989)	1977-87	97	21.50	-7.41
Germany	Wasserfallen & Whittleder (1994)	1961-87	92	17.58	-------
Germany	Schuster (1996)	1988-92	88	9.73	-14.13
Germany	Ljungqvist (1997)	1970-93	189	10.57	-12.10
Germany	Steib & Mohan (1997)	1988-95	103	6.81	-9.50
Greece	Papachristou (1995)	1990-92	42	57.49	-------
Greece	Kazantzis & Levis (1995)	1987-91	79	53.32	-8.50

Table 5-3 Continued					
Greece	Kazantzis & Thomas (1996)	1987-94	129	51.73	-------
Hong Kong	Dawson (1987)	1978-83	21	13.80	-9.30
Hong Kong	McGuinness (1993)	1980-90	92	16.59	-4.60
Italy	Cherubini & Ratti (1992)	1985-91	75	29.7	-------
Japan	Dawson & Hiraki (1985)	1979-84	114	51.90	-------
Japan	Jenkinson (1990)	1986-88	48	54.70	-------
Japan	Kaneko &Pettway (1996)	1989-93	37	12.00	
Japan	Packer (1996)	1989-91	158	13.90	-------
Korea	Kim *et al.* (1993)	1980-90	177	57.54	-------
Malaysia	Dawson (1987)	1978-83	21	166.60	18.20
Malaysia	Ariff *et al.* (1995)	1968-93	111	97.11	-------
Mexico	Aggarwal *et al.* (1993)	1987-90	44	2.80	-19.60
Netherlands	Wessels (1989)	1982-87	46	5.10	-------
Nigeria	Ikoku (1998)	1989-93	63	19.10	-14.60
Poland	Aussenegg (2000)	1991-98	149	35.6	-------
S. Africa	Page & Reyneke (1997)	1980-91	118	32.70	-63.45
Singapore	Dawson (1987)	1978-83	39	39.40	-2.70
Singapore	Saunders & Lim (1990)	1987-88	17	45.40	-------
Singapore	Hameed & Lim (1998)	1993-95	53	25.94	-------
Sweden	Bergstrom *et al.* (1995)	1970-91	160	33.57	-------
Sweden	Rydqvist (1997)	1980-94	249	34.13	-------
Switzerland	Kunz & Aggarwal (1994)	1983-89	42	35.80	-6.10
Thailand	Wethyavivorn & Koo-Smith (1991)	1988-89	32	68.69	-3.02
Turkey	Kiymaz (1997)	1990-95	138	13.60	44.10
Turkey	Ozer (1997)	1989-94	89	12.24	-------
U.K	Davis & Yeomans (1976)	1965-71	275	10.60	-------
U.K	Buckland *et al.* (1981)	1965-75	297	9.70	-------
U.K	Jenkinson & Espenlaub (1991)	1985-89	357	15.04	-------
U.K	Levis (1993)	1980-88	712	14.30	-11.38
U.K	Espenlaub *et al.* (1998)	1985-92	588	-------	-16.02
U.K	Espenlaub & Tonks (1998)	1986-91	428	12.20	-------
U.S.A	McDonald & Fisher (1972)	1969	142	28.50	-18.50
U.S.A	Bear & Curley (1975)	1969	140	12.90	-25.30
U.S.A	Block & Stanley (1980)	1974-78	102	5.96	-3.06
U.S.A	Ritter (1987)	1977-82	664	14.8	-------
U.S.A	Ritter (1987)	1977-82	364	47.8	-------
U.S.A	Aggarwal & Rivoli (1990)	1977-87	1598	10.67	-13.73
U.S.A	Ritter (1991)	1975-84	1526	14.32	-29.13
U.S.A	Cusatis *et al.* (1993)	1965-88	146	------	33.60
U.S.A	Loughran (1993)	1967-87	3656	-------	-58.94
U.S.A	Ibbotson *et al.* (1994)	1960-92	10626	15.26	-------
U.S.A	Loughran & Ritter (1995)	1970-90	4753	-------	-50.70
U.S.A	Affleck-Graves *et al.* (1996)	1975-91	2096	9.96	-7.56
U.S.A	Carter *et al.* (1998)	1979-91	2292	8.08	-19.92

Source: Al-Barrak, Abdulrahman M. (2003)

Table 5-3 also shows that emerging markets are more underpriced than developed markets. For instance, the Chinese market is underpriced on average by 948.59% and 289.2% (Su and Fleisher, 1999; Mok and Hui, 1998), and the Malaysian market is underpriced on average by 166% (Dawson, 1987). In contrast, the average abnormal

initial return for new issues in the UK and the USA tends to be around 15% (Levis, 1993; Ibbotson *et al.*, 1994).

Moreover, a few studies found that IPOs generate positive abnormal returns in the long run (Cusatis *et al.*, 1993; McDonald also Jacquillat, 1974; Jacquillat *et al.*, 1978; Dawson, 1987; Kiymaz, 1997). However, the majority of the studies show that IPOs underperform in the long run. Like the underpricing phenomenon, long run performance differs from one market to another.

5.4.3 Agency Costs

Hirschey (2000) defines an agency problem as:

> *"Present to the extent that unsolved material conflicts exist between the self-seeking goals of (agent) managers and the value maximisation goal of (principal) stockholders. Agency costs are the explicit and implicit transaction costs necessary to overcome the natural divergence of interest between agent managers and principal stockholders. Agency costs incurred by shareholders are reflected in expenses for managerial monitoring, the overconsumption of perquisites by managers, and lost opportunities due to excessive risk avoidance".*

Adam Smith (1776, p.700) said:

> *"Like the stewards of a rich man, they [managers] are apt consider attention to small matters as not for their master's honour, and very easily give themselves a*

dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company"

From previous definitions, the managers and the owners are the main components of the agency problem. Many researchers, such as Ang *et al.* (1999), and Singh and Davidson (2002), report a negative relationship between inside ownership and agency costs. This chapter shows that going public reduces the ownership structure of the founders, which could cause loss of control. Jensen and Meckling (1976) hypothesised that a firm's value declines when a 100% owner-manager sells off a portion of the stake in the firm.

Morck *et al.* (1988) used Tobin's q, which is highly correlated with ME/BE, as a measure of agency costs, a higher value indicating lower agency costs. Ang *et al.* (1999), and Singh and Davidson (2002) used the ratio of annual sales to total assets as a measure of agency costs. This ratio measures management's ability to employ assets efficiently. A high asset turnover ratio shows a large amount of sales that are generated for a given level of assets. A low ratio would indicate that management is using assets in non-cash flow generating and probably value destroying ventures. While a higher asset turnover may be identified with efficient asset management practices and hence shareholder value creation, a lower sales to asset ratio reflects asset deployment for unproductive purposes. Therefore, firms with considerable agency conflict will have lower asset turnover ratios relative to those having less agency conflict.

Jain and Kini (1994) found that the median percentage change in asset turnover of their IPO sample declined by 23.44% over a four-year window from -1 to +3. This decline indicates that the agency costs increased when these companies went public.

Nevertheless, Jain and Kini did not mention if the asset turnover decline was statistically significant.

McConaughy *et al.* (1995) used the market equity to book equity ratio to test the agency cost of IPOs that went public in 1985. They found that IPO firms had much higher ME/BE ratios at the beginning, but these dropped rapidly, especially in the 1985-87 period until, on an adjusted basis, they were insignificantly different by 1991. The ME/BE evidence would suggest that IPOs are subject to increasing agency costs as time progresses. Moreover, there was a small improvement in the median value of total asset turnover, increasing from 1.14 in 1985 to 1.29 in 1992. McConaughy *et al.* were able to avoid the problem of the study by Jain and Kini (1994). McConaughy *et al.* tested statistically of the changes in the agency cost were significant. However, as mentioned before, McConaughy *et al.* used the IPO-year as the base period. That allowed them just to test the agency cost after the IPO rather than agency cost pre- and post-IPO.

Additionally, Kim *et al.* (2004) documented a decline in asset turnover of their sample. The median percentage changes were -13.71, -23.57, -35.66, and -38.96 for years 0, +1, +2, and +3 respectively. However, they believed that the change in asset turnover relative to the industry was not significant. The study by Kim *et al.* was able to eliminate the problem of the study by McConaughy *et al.* since Kim *et al.* tested the agency cost pre- and post-IPO.

Finally, there is suggestion (indirectly) that whenever there is information asymmetry between the management and the owners (which is also true in the case of private companies going public), positive net present value projects with long time horizons are

systematically rejected. This imposes opportunity costs in terms of lost increments to shareholders' wealth.

5.4.4 Disclosure

Choi (1973, p.123) defined the disclosure concept as:

> *"The term disclosure can thus be thought of as the publication of any economic datum relating to a business enterprise, quantitative or otherwise, which facilitates the making of economic decisions. Economic data, in turn, includes facts which reduce the uncertainty concerning the outcomes of future economic events. Improved disclosure, for the present, can be thought of as the manifestation of an increase in both the quantity and quality of economic data disclosed by the enterprise-investor via its published financial reports".*

Gibbins and Waterhouse (1990) defined this concept as:

> *"Any deliberate public release of financial information, whether voluntary or required, numbers or words, formal or informal, any time during the year".*

Wolk *et al.* (1992) have a definition of the disclosure concept in a broad sense as the information presented:

> *"in both the financial statements and supplementary communications, including footnotes, post-statement events, management's analysis of operations for forthcoming year, financial and operating forecasts and additional financial*

statements covering segmental disclosure and extensions beyond historical costs".

Choi (1973), Firth (1979), Leftwich *et al.* (1981), Cooke (1992), Malone *et al.* (1993), and Wallace *et al.* (1994) all suggest that corporate disclosure may vary between publicly listed and private firms. This variation might be caused by listed corporations being required to comply with some registration regulations in order to trade in the stock market. Another reason for this difference is that listed firms are voluntarily increasing their disclosure in order to raise finance through the stock market (Al-Mulhem, 1997). However, the revealing of company information, such as forthcoming research and development projects might expose them to close scrutiny from the tax authorities, decreasing their scope for tax avoidance and evasion relative to private companies (Pagano *et al.*, 1998).

The idea that bank financing might be driven by a desire for confidentiality was first pointed out by Campbell (1979), who talked about disclosure as a major reason for companies to avoid obtaining funding in the public markets. Yosha (1995) documented that, in equilibrium, those firms with more sensitive information are deterred from going public if the costs of a public offering are sufficiently high.

Pagano *et al.* (1998) divided the taxes paid by IPO companies in Italy by operating income. They found an increase in tax pressure after the IPO. As a fraction of their operating income, IPOs pay about two persent more taxes per year than before, although the effect is imprecisely estimated. Pagano *et al.* argued that the greater accounting transparency associated with listing prevents companies from avoiding or evading taxes.

They found evidence in favour of the view that tighter accounting standards entail greater tax pressure, if the regression is re-estimated after adding a dummy for Italian subsidiaries of foreign companies, which are presumably forced by their parent company to keep to strict accounting rules, one finds that these companies pay 2% more tax than domestic companies.

Finally, Ransley in his survey (1984) documented that 25% of the people believe that the increased pressure on senior management due to closer public scrutiny was a major disadvantage, and disclosure requirements came second with 16%.

5.4.5 Moral hazard

The owners of a private firm can use the firm's resources for their own purposes, e.g. employment of relatives at favourable conditions and on-the-job consumption. When the stock of a firm becomes more widely held, private transactions, which reduce minority shareholder claims, are not allowed (Rydqvist and Högholm, 1995). However, the manager's incentives may change and the consumption of perks consumption may increase anyway (Jensen and Meckling, 1976).

5.4.6 Expenses and fees

There are a great number of direct costs (underwriting fees, accounting and consulting fees, register fees, etc.) associated with going public. Underwriters typically take at least 7% of gross proceeds (Ritter, 1998). On top of the initial expenses, there are the yearly payouts on auditing, stock exchange fees, certification, underpricing, etc. Because most of these expenses are fixed, their percentage is higher in small firms. A firm can end up

spending around 10-20% of the funds raised on the direct costs of listing. Hare (1994) says that a small offering of $10 million might cost the company $200,000 to $400,000, and a large offering of $50 million might cost the company $900,000 to $1.2 million. In addition, the management has to consider indirect costs such as time as well as effort. Table 5-4 shows the direct and indirect costs of going public for IPOs in the USA from 1990-1994.

Table 5-4 Direct and indirect costs, percent, of equity IPOs, 1990-1994

Proceeds ($Millions)	Gross Spending	Other Expenses	Total Direct Cost	Av. Direct & Indirect Cost	Number of IPOs
2-9.99	9.05%	7.91%	16.96%	25.16%	337
10-19.99	7.24%	4.39%	11.63%	18.15%	389
20-39.99	7.01%	2.69%	9.70%	18.18%	533
40-59.99	6.96%	1.76%	8.72%	17.95%	215
60-79.99	6.74%	1.46%	8.20%	16.35%	79
80-99.99	6.47%	1.44%	7.91%	14.14%	51
100-199	6.03%	1.03%	7.06%	12.78%	106
200-499	5.67%	0.86%	6.53%	11.10%	47
500-up	5.21%	0.51%	5.72%	10.36%	10
Total	**7.31%**	**3.69%**	**11.00%**	**18.69%**	**1,767**

Source: Lee, Lochhead, Ritter, and Zhao (1996)

Finally, Table 5-5 illustrates the major disadvantages and costs of going public. Again, the literature review shows that some of the results about the disadvantages of going public were inconsistent and therefore different opinions were raised.

Table 5-5 Summary of the literature review on barriers and costs of going public

Disadvantage	Supporting Studies	Rejecting Studies
Loss of Control	Rydqvist and Högholm (1995), Zingales (1995), Brennan and Franks (1997), Cai and Wei (1997) Mikkelson *et al.* (1997), & Pagano *et al.* (1998)	Jain and Kini (1994), & Kutsuna *et al.* (2002)
Adverse Selection	Leland and Pyle, (1977), & Chemmanur and Fulghieri (1995)	
Agency Cost	Jensen and Meckling (1976), Jain and Kini (1994), McConaughy *et al.* (1995), Ang *et al.* (1999) and Singh and Davidson (2002)	Kim *et al.* (2004)
Disclosure	Choi (1973), Campbell (1979) Firth (1979), Leftwich *et al.* (1981), Ransley (1984), Cooke (1992), Malone *et al.* (1993), and Wallace *et al.* (1994), Yosha (1995) , & Pagano *et al.* (1998)	
Moral hazard	Rydqvist and Högholm (1995)	
Administrative Cost & Fees	Lee, Lochhead, Ritter, and Zhao (1996), & Ritter (1998)	

5.5 The effect of an increased number of IPOs on the economy

Capital markets play an essential role in economic development since they directly affect two major development goals: mobilisation of savings and the channelling of investment into productive enterprises. The main reasons for capital markets are to attract an increased volume of medium and long-term savings into the financial system by offering investors a variety of financial institutions and investment opportunities and to improve efficiency in the allocation of financial resources by allowing a broad spectrum of entrepreneurs an opportunity to obtain financing for their projects. Therefore, capital markets are mechanisms for mobilising and channelling funds, which are received from surplus units and are allocated among deficit units. Consequently, these markets must satisfy savers and borrowers by providing a range of financial instruments and services at a reasonable cost. However, the primary purpose of capital market development is to strengthen the economy and thereby improve people's standard of living. Thus, efficient capital markets complement and support the productive activities of the economy (Ba-Owaidan, 1994).

According to Rousseau and Wachtel (2000), stock markets can stimulate economic performance by:

> *"(1) providing an exit mechanism to venture capitalists, (2) offering liquidity to investors that encourages international diversification and portfolio flows, (3) providing firms with access to permanent capital which can then be placed in large, indivisible projects, and (4) generating information about the quality of potential investments."*

An increased number of IPOs in a country could have an effect on macroeconomic variables such as economic growth, the balance of trade, the unemployment rate, the inflation rate, and vice versa. Unfortunately, few studies have investigated the link between the development of the stock market and economic development (Filer *et al.*, 1999).

Huybens and Smith (1999) showed theoretically and Boyd, Levine, and Smith (2001) proved econometrically that higher levels of inflation produce smaller, less active and less efficient banks and markets. Thus, there is a negative relationship between inflation and the volume of IPOs. Furthermore, GDP growth, attractive returns in the stock market and greater research and development expenditure may increase the demand for IPOs. However, increases in interest rates may also lead to a decrease in the supply of IPOs, as investment in loans is an alternative asset class to IPOs and private equity (Yu, 2002). Aylward (1998) found some evidence of this in the case of developing countries as well. In Central and Eastern Europe, there was a surge in the capital committed to IPO funds during 1994 and 1995, when the prospects for economic stability in the region improved.

Jeng and Wells (2000) argued that if the market relies on information on start-up firms (with good accounting regulations), venture capitalists would require less time to gather the information needed to monitor their investments. This will ultimately reduce the financing burden through a decrease in the cost of asymmetric information.

Atje and Jovanovic (1993) examined the relationship between the stock markets and economic growth. They found that stock markets had a strong and positive effect on growth over the period 1980-1988 for 40 countries.

Furthermore, Levine and Zervos (1998) empirically studied the correlation between stock market liquidity, size, volatility, integration with world capital markets, current and future rates of economic growth, capital accumulation, productivity improvements, and saving rates. They used data on 47 countries from 1976 through 1993. Levine and Zervos (1998) found that stock market liquidity had a positive and significant correlation with current and future rates of economic growth. They also found that market size and international integration were not strongly correlated with growth.

Rousseau and Wachtel (2000) conducted a study to examine if there was a link between liquidity and the size of the stock market and economic growth. They employed cross-sectional instrumental variable regressions on data from 47 countries. They found that the stock market was a significant player in promoting economic growth. Specifically, their findings indicated that the size of the marker alone is less important for growth in per capita incomes than the liquidity of the market and its interaction with size.

It should be said here that the studies by Levine and Zervos (1998) and Rousseau and Wachtel (2000) were comprehensive and strong, since their sample sizes were large enough, and both studies employed powerful statistical tests to find the correlation between the stock market liquidity and rates of economic growth.

5.6 The characteristics of IPOs

The decision to go public could be associated with particular kinds of companies, since the legal form of JSCs could be more appropriate to companies that have special characteristics, such as size, amount of debt, life stage, and industry. Ritter (1991) reported that the median age of the IPO sample, which consisted of 1,526 US firms, was just 6 years and median sales were 11.55 million dollars. Ritter concluded that the IPOs were small, in terms of sales, and young at the time of the IPO.

Matsuda *et al.* (1994) conducted a study to find the differences between the completed initial public offerings of Japanese and US firms. They distributed a questionnaire to 180 US companies newly listed on the NYSE and AMEX in 1988 and to 228 Japanese companies newly listed on stock exchanges and over-the-counter markets between 1983 and 1988. The response rate in the US was 13.3% and in Japan it was 34.6%. Matsuda *et al.* found statistically that the differences between Japanese IPOs and US IPOs related to age and size. Japanese IPOs are older and larger than their US counterparts. Their results also showed that the percentage of manufacturing firms in both groups was high, 62.5% in the USA and 55.7% in Japan. Finally, Matsuda *et al.* could strengthen their study by discussing more deeply the possible reasons behind the differences between USA and Japanese IPO firms.

Additionally, Rydqvist and Högholm (1995) obtained information from Swedish IPO prospectuses about company size, the size of debt, the age, and the business of the IPOs. They found that at the time of the IPO, the firms were old. The average age was 38 years old. They concluded from the market value of equity and the book value of debt that the average firm was large at the time of going public. The mean and median of the firm size was 773 and 215 million Kroner respectively. Rydqvist and Högholm (1995) also found, on average, that the assets of the IPOs were financed almost 50% from debt and 50% from equity. With regard to the business of the IPOs, they found that the most frequent businesses were manufacturing and services. Agriculture, mineral production, and heavy industry were rare. However, it could be argued that the findings of Rydqvist and Högholm were not reliable since they did not compare their IPO sample with reasonable matching firms and also did not employ powerful statistical tests to find if the differences between their IPO sample and the matching firms are significant.

Cai and Wei (1997) found that the average IPO size in their sample was 441 million dollars while the average industry median was 377 million dollars. They showed that these IPOs were larger than the average for the industry. But, it should be said here that Cai and Wei investigated only one characteristic of the IPOs which is the size and also despite compared their IPO sample to the a relative industry, they did not clarify if the differences are statistically significant.

Torres (1997) explored the characteristics of firms making initial public offerings in Mexico. Torres made comparisons between public and private firms. He found statistically that larger, more profitable firms and firms in sectors with higher market-to-

book ratios are more likely to make an IPO. In addition, the coefficients indicate that private firms with relatively few collateral assets and relatively low leverage, and which rely more on banks as their source of finance than other closely held firms, are more likely to choose to float their stock. Therefore, he concluded that, among the closely held firms, companies with less access to sources of debt finance are more likely to choose to become listed. Finally, Torres overcame the weak points that other studies, such as Rydqvist and Högholm (1995), have when he investigated the characteristics of the IPOs by comparing his sample to matching firms and tested the significant differences.

Pagano *et al.* (1998) compared their IPO sample with a sample of firms that did not list despite meeting the listing requirement. They showed that the median total assets of their IPO sample was 163.3 billion of Italian lire and the mean total assets of their sample was 440.8 billion of Italian lire. On the other hand, the median and mean of the total assets of the sample eligible to go public were 59.9 and 222.5 billion of Italian lire respectively. In terms of sales, the IPO sample was larger by 60 billion Italian lire than the matching firms. Moreover, the median company in the sample was more profitable (the median return on assets was 14%), had less leverage (the median ratio of debt to capital was 33%), and invested more by 24%. It is the same problem again, Pagano *et al.* (1998) comparing their sample with suitable matching firms but they did not employ powerful statistical tools to find if the differences between the two groups were significant.

Kutsuna *et al.* (2002) reported that the mean age of their IPO sample was 31 years, the mean number of employees was 475. They also showed that 35.2% of the IPOs were in manufacturing, and 30.0% of the IPOs were in the wholesale and retail trades. The study

by Kutsuna *et al.* was one of fewest studies that reported the average number of IPO employees, but they did not clarify if this number considered in Japan low, normal, or high.

Finally, Kim *et al.* (2004) calculated the mean and median of the total assets, and the age of the firm. They found that the total assets of firms, prior to or at the offering, were 0.96 billion Thai Baht for the mean and 0.51 billion Thai Baht for the median (US$ 1 ≈ 24 baht at that time). They also found that the mean and median of the age of the firm, since establishment, was 14.37 years old and 11.50 years old respectively. Kim *et al.* did not mention if this average age was considered either old or young for Thai firms.

In general table 5-6 shows a summary of the literature review on the characteristics of IPOs.

Table 5-6 Summary of the literature review on the characteristics of IPOs

Study	Country	Findings
Ritter (1991)	USA	IPOs are small and young
Matsuda *et al.* (1994)	USA	IPOs are small and young
Matsuda *et al.* (1994)	Japan	IPOs are large and old
Rydqvist and Högholm (1995)	Sweden	IPOs are old, large, financed 50% by equity and 50% by debt, and manufacturing and services
Cai and Wei (1997)	Japan	IPOs are large
Torres (1997)	Mexico	IPOs are large, profitable. IPOs have high market-to-book value. IPOs have less access to sources of debt finance
Pagano *et al.* (1998)	Italy	IPOs are large, and profitable. IPOs have less leverage and invest more
Kutsuna *et al.* (2002)	Japan	IPOs are old and manufacturing and whole and retailer trade
Kim *et al.* (2004)	Tai	The median age is 11.55 and the median size is 0.51 billion Thai Baht

5.7 Summary

From international empirical evidence, the consensus is that when companies go public, their operating performances decline. The reasons for this decrease in operating performance were presented. The level of importance of these reasons varied from one to

another and from country to country. Most researchers have different and conflicting opinions about the reasons behind this anomaly[26]. The reasons for this decline that met with most blame are changes in the ownership structure, and the window of opportunity, in which owners issue new shares when their companies are substantially overvalued.

Additionally, there was a review of the pros and cons of going public. Again, there is no consensus of opinion about the benefits and costs of IPO. Though there are certain costs in going public, it can be seen that the benefits are numerous.

Moreover, the relationship between the economy and IPOs were also presented in this chapter. Several studies were able to find a relation between the two components. Most of the studies investigated the effect of macroeconomic factors on the stock market. For example, some studies found a positive correlation between GDP growth and the demand for an IPO. However, there is a lack of studies that investigate the effect of the booming of IPOs on macroeconomic variables.

The last section in this chapter dealt with the characteristics of IPOs. Many studies found that larger, older, manufacturing companies are more likely to go public. Since IPOs occur in more mature industries, where access to finance for growth is often cited, it shows that there are other important motives for going public rather than a growth motive.

Finally, making a comprehensive literature review of the current IPOs issues is considered to be a very fundamental step for this research. By reviewing a great number

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[26] One of the difficulties with the statistical exercises is that it is difficult to control for alternative hypothesis. One research method that would address the issue is the case study approach, and this is one of the methods employed in this research.

of studies and by reviewing the Saudi business situation (Chapter Two, Three, and Four), the researcher in current study was able to;

- determine the most appropriate methods that could be used to collect the necessary data. The majority of the studies reviewed obtained their data from reliable databases. However, next chapter (the methodology chapter) will show that this approach was unfeasible in this research, since Saudi Arabia lacks a database that has such needed information.
- build and develop a complete questionnaire and interview which would produce valid and reliable answers to the main research questions, and
- find out the most suitable and acceptable statistical tests that could be employed.

6.1 Introduction

Blaikie (1993, p.7) defines the concept of methodology as:

> "*the analysis of how research should or does proceed. It includes discussions of how theories are generated and tested – what kind of logic is used, what criteria they have to satisfy, what theories look like and how particular theoretical perspectives can be related to particular research problems*"

The main thrust of this research is to collect empirical evidence capable of providing an overview of current initial public offerings (IPOs) in Saudi Arabia. From the researcher's knowledge, no empirical research has been conducted to find the possible factors that motivate or discourage companies in Saudi Arabia to seek public equity, nor has empirical research been conducted to investigate the effect of IPOs on firms and the economy in Saudi Arabia. Therefore, the previous chapters explored many issues relating to the decision to go public in Saudi Arabia and many other countries in order to find the best methods that could be implemented in this research to collect the necessary data.

This chapter is significant since it, firstly, discusses the different methods which have been employed in similar and previous studies to collect and analyse the data. Secondly, it discusses the approaches adopted in this study to answer the research questions and justify the choice of these approaches. Thirdly, it describes the population and sample selected in this study, justifies this selection, explains the necessary steps that have been

taken in designing the questionnaire and interviews and discusses the techniques employed to increase the response rate. Finally, it reviews the process that has been followed to ensure this study is valid and reliable.

Briefly, this chapter consists of three main sections. In the first section, the research methods adopted in similar studies are discussed. The second section reviews data collection techniques used in this research. The last section discusses the validity and reliability of this study.

6.2 Research methods adopted in similar studies

This section deals with the research methods used to collect and analyse the data needed to answer the main research questions. The majority of previous studies used secondary data and applied statistical techniques to answer the research questions. However, other studies, such as Ransley (1984), adopted postal questionnaires and interview techniques to collect their data (primary data).

6.2.1 Primary data

Primary data is that data collected by the researcher. The main methods used to collect such data are questionnaires and interviews. These two instruments will be discussed later in this chapter

6.2.2 Secondary data

The secondary data is data collected or prepared by other researchers or institutes. For example, researchers in the finance field use data collected by governmental or private

institutes to investigate a particular phenomenon. Social scientists are increasingly using data collected by others for research purposes that vary from the original reasons for collecting the data (Nachmias and Nachmias, 2002).

6.2.2.1 Reasons for using secondary data

There are three basic explanations for the increased dependency on secondary data (Nachmias and Nachmias, 2002):

- ***Conceptual-substantive reasons***

Researchers in some subjects, such as political and social historians, may find that secondary data is the only data available for the study of certain research problems. Secondary data might help researchers to have a better understanding of the historical context by analysing data collected in different times on similar issues. Secondary data may be employed for comparative purposes. Hyman (1987, p.17) suggests that:

> *"secondary analysis of a series of comparable surveys from different points in time provides one of the rare avenues for the empirical description of long-term changes and for examining the way phenomena vary under the contrasted conditions operative in one [or several] society[ies] at several points"*

- ***Methodological reasons***

There are many methodological advantages to secondary analysis, summarised below (Nachmias and Nachmias, 2002):

1. Secondary data, if reliable and accurate, provides opportunities for *replication*. A research finding gains more credibility if it appears in a number of studies.
2. The availability of data over time enables the researcher to employ longitudinal research designs.
3. Secondary analysis may improve measurement by expanding the scope of independent variables employed in the operationalisation of concepts.
4. By using secondary data, the researcher can increase the sample size and the number of observations that could lead to more encompassing generalisations.

- ***Economic reasons***

Primary data costs researchers more to obtain than secondary data does. Therefore, many researchers prefer to use secondary data rather than primary data.

6.2.2.2 Disadvantages of using secondary data

Like any other data collection, secondary data has its disadvantages. Perhaps the most serious problem in using secondary data is that often they only approximate the kind of data that the investigator would like to employ for testing hypotheses (Nachmias and Nachmias, 2002). There is an inevitable gap between primary data the investigator collects personally with specific research purposes and intentions in mind, and data others collect for other purposes.

The second disadvantage is access to such data. The researchers may face some difficulties in finding the data that is related to the research problem. Some of the data

might be inaccessible because the original researcher has not released them. Researchers are not required to make their material data available for secondary users.

Finally, secondary data analysis may be compromised if the researcher has insufficient information on how the data was collected (Nachmias and Nachmias, 2002). The importance of this information is to determine potential sources of bias or errors, or problems with internal or external validity.

In this research, the researcher used secondary data to answer the main questions. However, some documentations was also obtained from a company that went public in Saudi Arabia (More information about these documentations will be discussed later in this chapter).

6.3 Data collection techniques used in this research

The main purposes of this study are to investigate empirically (1) the motivations for going public in Saudi Arabia, (2) the barriers affecting the rate of going public in Saudi Arabia, (3) the impact of the decision to go public on the performance of the IPOs, (4) the impact of an increased number of IPOs on the Saudi economy, (5) the characteristics of IPOs, and (6) suggestions to increase the rate of IPOs in the country.

To answer these questions, the researcher adopted three major approaches. Firstly, the researcher conducted a case study. The financial statements of one company that switched from private to public ownership were studied and analysed in depth by using financial ratio technique. After the analysis, the researcher interviewed the senior managers of that company. Secondly, the researcher conducted a questionnaire survey

distributed to the CEOs of the 500 largest Saudi Arabian companies, in term of sales. Thirdly, the researcher interviewed three managers and owners of companies that had made IPOs and asked them for their opinions on the major issues related to the decision to go public.

In the early stages of this thesis, the researcher intended to study IPO activity by investigating many case studies. The researcher dispatched letters to all companies that went public in the country on 11-06-2002, asking if they were willing to cooperate with the researcher and provide all the necessary documents. Moreover, on the same date, a letter was dispatched to the Ministry of Commerce asking if they could provide the researcher with such information. Reminder letters were dispatched on 17-08-2002. Unfortunately, only one company acceded to the researcher's request and sent the required documents, its financial reports, and prospectus.

To increase the validity and reliability of the study, the researcher, therefore, decided to use other methods (a questionnaire and interviews) to fulfil the research objective (the justifications for using these techniques will presented later in this chapter). The researcher distributed the questionnaire first and asked the participants at the end of it if the participant's company had moved from being a private to a public company and whether he or she had any objection to being interviewed, to discuss some of the questions in more depth (see Appendix B). Only two businessmen put their names forward and were willing to be interviewed. Moreover, the researcher was able to add another more businessman, who had taken his companies public, when the researcher met his son at a conference and asked him to ask his father to participate in the current study.

The researcher in this study understands that it would have been better if he had undertaken the interviews before distributing the questionnaire. However, because of the time limitation and the initial difficulties in finding well-experienced businessmen, the researcher started with the questionnaire. To eliminate this disadvantage, a pilot study was conducted to improve the quality of the questionnaire with three groups, academics, PhD students, and normal businessmen (the pilot study process is discussed fully later in this chapter).

Finally, the researcher believes that employing three studies (a single case study, questionnaire survey, and interviews) in a complementary way provided an obvious picture of the IPO activities in Kingdom. The analyses of the single case study, questionnaire, and interview data complemented each other as follows:

1. The single case study enables the researcher to investigate the real effect of the going public decision on the company's financial indicators, such as the profitability, capital structure, and growth.
2. The questionnaire facilitates the researcher to find the perceptions and attitudes of high number of businesspersons towards the current IPO issues.
3. The interview data is employed in this research to complement the findings obtained from the case study and the questionnaire.

The following subsections discuss each of these three methods in some depth.

6.3.1 The case study

Yin (1994) defined a case study as:

> *"An empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident."*

According to Yin (1994), case studies are the favoured strategy when "what", "how", or "why" questions are being posed and when the researcher wishes to understand an organisational phenomenon in its real-life context. Case studies designed to determine "how" or "why" events occur as explanatory studies. Case studies can be undertaken using either qualitative or quantitative evidence or both.

A case study can be designed to take one of these four forms[27] (Yin, 1994):

- Single-case, holistic designs
- Single-case, embedded designs
- Multiple-case, holistic designs
- Multiple-case, embedded designs

Figure 6-1 Basic types of designs for case studies

	Single-case designs	Multiple-case designs
Holistic (single unit of analysis)	Type 1	Type 2
Embedded (multiple units of analysis)	Type 3	Type 4

Source: Yin (1994)

[27] A case study is considered holistic if it studies the company or the organisation as one single unit. A case study is considered embedded if the researcher divides the company or the organisation into multiple units and study each unit as a separate case.

Using the case study approach enables the researcher to choose between multiple data collection techniques. According to Yin (1994), the most useful data sources used in the case study method are documentation, archival records, interviews, direct observation, participant-observation, and physical artifacts. In this research, the data collection tools used were documentation and interviews.

Firstly, copies of all the financial reports and the prospectus of the company under investigation were obtained from the company itself. Secondly, to eliminate the problem of lack of marching firms data, confirm, and justify the findings from the financial ratio analysis, the researcher in this study made further investigations by conducting in-depth interviews with the CEO and the Financial Manager of the company (more information about this technique will be presented later in this chapter. See Appendix A for the interview questions).

6.3.1.1 The financial test used to analyse the company's financial statements

To identify the actual effects on financial performance as well as the real reasons for making the decision to go public, financial ratio analysis (a way of comparing and investigating the relationships between different pieces of financial information) was employed to assess the company performance prior and post the IPO.

Ratios by themselves have little meaning. For example, a firm with a current ratio of 1.5 may be cash rich, whereas another firm that has a great deal of inventory and a 4.6 current ratio may be struggling to pay its bills. To make ratio analysis more productive, the ratios have to be compared with others, and this can be done by using interfirm or

intrafirm analysis. An interfirm analysis interprets ratio values by comparing the financial ratios of a company to the financial ratios of a related firm at one point in time. Interfirm analysis involves no time dimension and can thus be considered a "static" ratio analysis (Rao, 1995). Intrafirm analysis interprets ratio values by examining the behaviour of a firm's individual ratios over time (Rao, 1995). Intrafirm analysis was used in this research, because, firstly, the aim of adopting financial ratio analysis in this study was to discover the changes in financial and management performance between the period before the IPO and the period after the IPO. Secondly, interfirm analysis cannot be used in this study since there is no reliable data about other companies working in the same industry. The profitability, liquidity, debt, turnover, and growth ratios were calculated. More details of these ratios are discussed in Chapter Seven (The case study chapter)

It should be said here also that ratios alone are not a complete answer to assessing performance, but they provide the analyst with guidelines for asking the right questions to discover areas requiring more investigation to establish the full picture of company performance.

Furthermore, certain accounting numbers in the financial statements require some adjustment to generate ratios that are representative of the actual business performance. These adjustments are essential in order to eliminate any distortions that may be caused by actions such as loss of goodwill, write off of debt, or the revaluation of assets. For instance, the return on assets (ROA), the return on equity (ROE), and the debt ratios are significantly affected by goodwill. Writing off goodwill to the capital reserve, with no impact on earnings, produces ratios that give a favourable impression because the full

amount of capital employed on the balance sheet is understated, and the associated capital costs are ignored in the profit and loss account.

In addition, the usefulness of ratio analysis also depends on the disclosure of information in the published accounts. The law does not require companies to reveal all information. Consequently, some of the information required to compute some of the ratios might not be available. This necessitates the use of other published data to make the calculations for ratios thus affected.

Thus, from the above discussion, the financial ratio analysis technique is not perfect, and has several major limitations. Some significant disadvantages are:

1. The calculation of ratios is limited to publicly disclosed information. The information so revealed is, in some cases, not sufficiently detailed to calculate some of the ratios.
2. The method of allowing goodwill to be written off from the shareholders' fund on the balance sheet with no impact on the profit and loss account, results in financial ratios that do not use appropriate capital employed and profits figures.
3. Making ratio comparisons over time between a particular company and other companies or between different time periods in the company itself could be difficult, since individual companies in the same country may adopt different accounting policies that affect many items in the balance sheet and the profit and loss figures.

However, despite these disadvantages, there are number of advantages from adopting the financial ration technique in assessing company financial managerial performance. Some of these advantages are:

1. The majority of the calculations can be made quickly and directly from the summarised balance sheet and profit and loss accounts of the published reports and accounts of the company.
2. Financial ratios allow the users to compare companies that cover a wide range of sizes.
3. Comparisons can be made with companies in the same industrial sector and over the whole market.
4. The use of ratios can enable the analysts to relate accounting and non-accounting data. For instance, several investor ratios relate accounting data to the share price.
5. The preparation of a small number of key ratios simplifies the examination of the extensive amount of data contained in the annual report and accounts

6.3.1.2 The justifications for using the single case study technique

The case study method is used in this particular investigation for many reasons. Firstly, one of the purposes of this research was to explore the real financial effects caused by IPO on the firms. Investigating and analysing financial statements from the last five fiscal years before the initial public offering to the first five fiscal years after the offering enabled the researcher to make a legitimate comparison between the two periods and capture the effects of the IPO on the company.

Secondly, another purpose of the study was to understand the motivation for going public and the barriers affecting the rate of IPOs in Saudi Arabia. In-depth interviews with senior managers assisted the researcher in sharing their experience and ideas about these particular issues.

Thirdly, there have been few IPO cases occurring in Saudi Arabia in the last two decades. In addition, there is no database collating all the necessary data needed for running statistical analysis on many companies. The researcher was able to identify the companies that went public from the late 1980s until now by obtaining information from newspapers, and by asking all the companies listed in the stock market if they had made an IPO. Just ten IPO cases occurred in Saudi Arabia from 1988 until 2004. As has been mentioned before, the researcher tried to increase the number of case studies, however, only one company was willing to co-operate with the researcher's request and sent its financial reports and prospectus.

6.3.2 The questionnaire survey

The Questionnaire is a widely used technique for data collection and a major tool for collecting primary data. Researchers can distribute their questionnaires by using several methods. They can post questionnaires to respondents; they can distribute their questionnaires to participants in the study by themselves and collect them later; or they can carry out their questionnaires by making phone calls to respondents.

A questionnaire survey is helpful for collecting moderate amounts of information from large samples of people, particularly when resources are limited (Hibberd and Bennett,

1990). Moreover, questionnaires are suitable for collecting information about attitudes, motivation, accounts of behaviour, opinions, and events (Arksey and Knight, 1999).

6.3.2.1 Advantages of the questionnaire survey

- ***Less expensive***

Low cost is considered one of the most important advantages of using questionnaires, especially postal questionnaires. Postal questionnaires cost only the time for planning, sampling, and duplicating, and the direct costs of postage, and providing stamped, self-addressed envelopes for returns (Nachmias and Nachmias, 2002). Moreover, funds are not required for the training of interviewers. In addition, it is more inexpensive and simpler to process and analyse postal questionnaire than other techniques. The lower cost of administrating a postal questionnaire is particularly evident when the population under study in spread over a wide geographic area. In this situation, the cost of interviewing might be become prohibitive, and the postal questionnaire may be the only suitable and practicable method (Nachmias and Nachmias, 2002).

- ***Confidentiality***

Anonymity is an essential factor affecting the accuracy of the answers and the rate of response, especially with sensitive subjects. Respondents can answer questions in postal questionnaire freely with great secrecy.

- ***Accessibility***

When the population under investigation is spread across a large geographic area, the postal questionnaire technique enables the researcher to cover the population at low cost. For example, if the researcher used the interview method, it might be necessary to travel a lot, which might cost too much.

- ***Considered answers and consultation***

Postal questionnaires are helpful when questions require a considered (rather than an immediate) answer or if answers require respondents to consult personal documents or other people (Nachmias and Nachmias, 2002). Postal questionnaires enable respondents to be free to answer in their own time and at their own pace.

- ***Reduction in bias errors***

By using the postal questionnaire method, the researcher can decrease bias, which might be caused by the personality of interviewers and the variability of their skills.

- ***Less time to collect data***

Timing is a fundamental factor for researchers who have a specific time period in which to complete their project. By using the questionnaire method, the researchers can distribute and collect questionnaires quickly and then analyse them to come up with answers to their research questions.

- ***Large samples***

Because costs are low and data collection is fast, it is feasible to survey large samples of the population (Aldridge and Levine, 2001).

6.3.2.2 Disadvantages of the questionnaire survey

- ***Low response rate***

Low response rate is the most serious problem. The average response rate for postal questionnaire without follow-up is between 20 and 40% (Nachmias and Nachmias, 2002). However, mail survey projects with a return of 30% or so are often considered satisfactory (Dillman, 1978). The researcher may increase the response rate by making a diligent effort to stimulate responses through careful design, skilful execution, and follow up procedures (will be discussed later in this chapter)

- ***Questionnaire length***

Self-completion questionnaires need to be short and also look short, or the response rate will be low (Aldridge and Levine, 2001). Using a mail survey, the researcher should expect that much information will not be secured. It is generally believed that participants will refuse to co-operate with long and/or complicated postal questionnaires.

- ***Simple questions required***

A postal questionnaire is used as a method for data collection only when the questions are straightforward enough to be comprehended solely on the basis of printed instructions and definitions (Nachmias and Nachmias, 2002).

- ***No opportunity for probing***

Researchers have to accept the answers given as final and they have no opportunity to probe beyond the given answers, to clarify ambiguous answers, or to appraise the nonverbal behaviour of respondents (Nachmias and Nachmias, 2002).

- ***No control of the context of response***

Neither has the researcher control over who fills out the questionnaire, nor the spirit in which they do so. To have a representative sample, the researcher has to have control over who completes the questionnaire, but, with a postal questionnaire, it is difficult to do so. Addressing the questionnaire to a named individual is one way to minimise this problem.

- ***Human error***

The respondents can unintentionally check the wrong boxes. This kind of error can be reduced by designing the questionnaire to be clearer.

6.3.2.3 The justifications for using the questionnaire technique

The second (and major) approach used in this research was a postal questionnaire distributed to the CEOs of the 500 largest firms in Saudi Arabia (see Appendix B). The postal questionnaire was used in this research because of its significant advantages over other techniques. Firstly, the use of the postal questionnaire facilitated the collection of the wanted data from the large sample. Secondly, the wide-spread location of managers in various cities clearly made a postal questionnaire the most suitable tool regarding cost and time. Thirdly, since the research's aims were to collect data about the motivation, barriers, and effects of going public in Saudi Arabia on firms and the economy from the CEOs of the 500 largest firms in the country, a postal questionnaire was the only technique that could be realistically employed. Fourthly, because the respondents in this study are the managers of the top 500 companies, who are usually well educated, have reasonable experience, and have sufficient knowledge of the business environment in Saudi Arabia, they would recognise that this study is highly relevant to their jobs and businesses and they may benefit from the results of the study, to enhance their decisions in the future. Therefore, participants would have been more solicitous when answering the questions. In addition, they are well-placed to provide reliable and valuable information that could be used to answer the study's questions. Fifthly, the availability of up-to-date communications data for the top 1000 Saudi companies, including names of the firms, current P.O. Box and postcodes, telephone numbers, the amount of assets and capital etc., encourages the adoption of a postal questionnaire. Finally, the postal questionnaire approach has been accepted and used in previous and similar studies (Ransley, 1984; Matsuda *et al.*, 1994; Burton *et al.*, 2003).

6.3.2.4 Techniques adopted to increase the response rate

As discussed previously, the questionnaire method is associated with some disadvantages. The most important disadvantage is a low response rate (Sekaran, 1992). Cooper and Emory (1995) consider a mail questionnaire with a return rate of about 30% to be reasonable. Alarfaj (1996) considers a mail questionnaire with a 15% response rate in Saudi Arabia, where the study was conducted, to be satisfactory. However, the researcher employed several techniques to increase the rate of return. These techniques were:

- ***Questionnaire length***

Kanuk and Berenson (1975) suggest that keeping the questionnaire as short as possible would help to increase the response rate of a mail questionnaire. The researcher in this study designed the questionnaire to be as concise as possible.

- ***Follow-up***

Follow-up letters, which remind and encourage the participant to complete and return the questionnaire, help to increase the response rate. The researcher in this study used this technique by sending a letter three weeks after sending the questionnaire, to all participants, thanking those who had responded and reminding those who had not (see Appendix C). As well as the follow-up letter helping to increase the response rate, the follow-up was used to test the reliability of this study.

- ***Survey sponsorship***

The sponsorship of a questionnaire has a great impact on participants (Nachmias and Nachmias, 2002). Thus, an official letter from the researcher's sponsor, King Faisal University, identifying the researcher and also asking the participants to co-operate with him was attached with the questionnaire (see Appendix D).

- ***Return envelopes***

Some studies suggest that providing a stamped return envelope persuades participants to respond (Emory, 1985). Therefore, the researcher in this study enclosed with every questionnaire a stamped self-addressed return envelope.

- ***Confidentiality***

The researcher in this study assured respondents that all survey data obtained from them would be used as confidential.

- ***Timing of mailing***

The timing of the mailing, to some extent, affects the response rate. For example, summer and holidays produce the lowest response rate. It is not recommended, therefore, to mail questionnaires during those times (Nachmias and Nachmias, 2002). The questionnaires and the follow-up letter in this study were dispatched in February and March 2003 respectively. The researcher believes that this period was a suitable time for collecting data from the top managers working in Saudi Arabia, because top managers usually take their vacation and leave the country in the summer season, which start on late June.

6.3.2.5 Questionnaire design

In general, questionnaires usual consist of three kinds of questions. The first type is factual questions dealing with the participant's background and characteristics, such as age, marital status, nationality, education, and gender. The second kind is administrative questions, which contain place, date, and conditions of the interview. The third type is measurement or subjective questions, which are usual the most important questions in any questionnaire. These measurement questions could be facts, preferences, attitudes, ideas, prejudices, or perceptions about a specific issue (Cooper and Emory, 1995; Nachmias and Nachmias, 2002).

The questionnaire in this study was designed to be easy to read, answer, and analyse. The questionnaire in this study also was based on earlier studies such as Ransley (1984) and Matsuda *et al.* (1994). However, great adjustments were made on the original questions to reflect the specific objectives of this study and the unique characteristics of Saudi Arabian business environment. It contains six sections with a total of seventeen general questions (see Appendix B). Participants were asked to express their views by using a 5-point Likert Scale (1= strongly disagree and 5= strongly agree) for most of the major questions (10, 11, 13, 14, 15, 16, and 17).

The objectives of the questionnaire were briefly stated in the questionnaire's covering letter, which also stressed the confidentiality of all information provided and that such information was to be used for the purpose of the study only. To encourage target groups to participate and respond to the questionnaire, the anonymity of the respondents was guaranteed by not asking respondents directly to identify their organisations.

The first section consisted of nine questions related to the participant's background, organisation, and job. The researcher used the information obtained from this section to find if background differences affected the respondents' answers.

The second section, question ten, dealt with one of the major research questions. Question ten asked the respondents to rank twenty-eight possible motivations, which might encourage firms in Saudi Arabia to go public. These twenty-eight motivations were categorised into four groups. Five were categorised as motivation related to original owners, fourteen as motivations related to private firms, four as motivations related to the market, and five as motivations related to regulations.

The objective of the third section, question eleven, was to discover the barriers to going public in the Kingdom. Twenty-two possible barriers were listed, and participants were asked to rank them. These twenty-two barriers were classified into four groups. Four barriers were classified as barriers related to original owners, seven as barriers related to private firms, six as barriers related to the Saudi market, and five as barriers related to regulations.

Question twelve, section four, asked respondents whether the profitability of IPOs would (A) increase (B) decrease (C) not change or (D) they did not know. Then question thirteen, in the same section, asked participants who believed IPO profitability would increase, to express their views by using a Likert Scale for seven possible reasons that would affect IPO performance positively. In question fourteen, in section four, the reasons that would affect IPO performance negatively were presented to only the

participants who believe IPO profitability would decrease. Six potential reasons were listed and participants gave their opinions.

Question fifteen, in section four, was aimed at revealing the effect of an increase in the number of joint stock companies would have on the Saudi economy. Seven economic factors which would be affected by an increase in the number of IPOs were listed, and participant were asked to express their opinions.

The goal of section five, question sixteen, was to find out whether the decision to go public was associated with particular kinds of companies. Eleven types of companies were presented and respondents were asked to indicate their views.

Section six dealt with suggestions which would improve the rate of going public in the Kingdom. Thirteen suggestions, five for private firms and eight for the Saudi government, were listed, and respondents were requested to give their opinions about these suggestions.

6.3.2.6 The pilot study

Each survey questionnaire presents its own problems and difficulties before it reaches the final draft. Questionnaires have to be designed, and tried out, improved and then tried out again, often several times, until it is certain that they can do the job for which they are intended (Oppenheim, 1992).

The objective of a pilot study is to determine the weak points in the instruments applied. A pilot study enables the researcher to identify ambiguity in the wording, a poor ordering of questions, unnecessary questions, and the length needed to complete the question.

After writing the first draft, the researcher in this study distributed the questionnaire to three groups. The first group was six Accounting and Finance Ph.D students who speak English and Arabic fluently. The second group was ten professors from the Department of Management, the Department of Accounting, and the Department of Economics at King Faisal University (the researcher's sponsor). The third group was eight Saudi businessmen.

All three groups contributed significantly to improve the questionnaire. The researcher received highly valuable feedback, especially about the language and translation from English to Arabic. In addition, the third group was asked also to complete the interview questions. The researcher re-phrased some questions and also added some according to the suggestions received from these eight businessmen.

6.3.2.7 The population and the sample selected

The population of interest is usually apparent from the management problem and the research objectives. The main goal of this study was to ascertain the opinions of the top managers of private sector firms regarding the current IPO activities in Saudi Arabia. Thus, the relevant population was CEOs (chief executive officers) of all firms operating in the Kingdom, regardless of their legal status, size, age, and sector.

The researcher decided to choose the managers of the top 500 Saudi companies as a sample for this study. There were several reasons for this selection. Firstly, because these managers are well educated and experienced, they were able to provide helpful information for answering the research questions. Secondly, the expected response rate was higher, since these managers are well educated, organised, and concerned. Thirdly, most of these companies are in a position to go public since they are large and have the required operational history. Fourthly, some of these companies have already switched to public ownership, and therefore the managers of those companies have more information on the issue. Fifthly, an up-to-date list of the top 1000 Saudi Arabian firms is available. This list contains all necessary information, such as the firm's name, owner(s), capital, sales, number of employees, and address.

6.3.2.8 The statistical tests used to analyse the questionnaire data

As has been discussed before, a 5-point Likert Scale was used for most of the major questions in the questionnaire, creating multiple-item indicators. Firstly, in this study, parametric and non-parametric tests were employed. The parametric tests used were t-test and analysis of variances (ANOVA). Non-parametric test employed was chi-square test. For ordinal scale, t-test used to ascertain if there were significant differences between two independent variables and analysis of variances (ANOVA) was used to find if there were significant differences between more than two independent variables. For categorical scale, chi-square test was used to find if there were significant differences between independent variables. Secondly, descriptive statistic, such as the means, standard deviations, coefficients of variation, and frequencies, was calculated helping to rank

respondents' average responses to a problem or an issue in order (Chapter Eight, the analysis and results of the questionnaire and interview data, will have more discussion on those tests).

6.3.3 The interview technique

Interview technique is a direct encounter between the researcher, known as the interviewer, and the participant. The interviewer asks questions from the interview schedule, and records the respondent's answers. Researchers can construct their interviews to take different kinds of shape. There is the schedule-structured interview, in which the number of questions and the wording of the questions are identical for all respondents (Nachmias and Nachmias, 2002); semi-structured interviews, for which the question are prepared but the interviewer gives the respondents considerable freedom to express their definition of a situation that is presented to them; and unstructured interviews, in which the questions are not predetermined.

The interview method is useful when a lot of information is needed from a sample of people, and when those people may not be motivated to complete a questionnaire by themselves (Hibberd and Bennett, 1990). In addition, interviews are preferable the longer, the more difficult, and the more open-ended the question schedule is (Oppenheim, 1992).

In this study, personal interview was also chosen to collect data and the semi-structured interview type was adopted (see Appendix A). The researcher in this study formulated detailed questions in advance and asked the interviewees, face-to-face, these questions.

The interviewees were given the flexibility to probe for details and discuss issues. All the interviewees were asked to give their opinions about the current IPO issues covered in this study (the main research questions).

However, beside the general questions, the first group, the single case study, was asked more detailed questions. After analysing the financial statements by using the financial ratios analysis, the researcher was able to identify the real changes that happened before and after the IPO on the company's profitability, growth, debt level, liquidity, and turnover. Therefore, both interviewees, the CEO and the Financial Manager, were asked whether the going public decision has played a fundamental role in these changes (see Appendix A).

6.3.3.1 Advantages of the interview technique

- ***High response rate***

Because of the personal interaction between interviewer and the participants, the response rate from this technique tends to be higher than other types of survey. The response rate can reach 95% (Nachmias and Nachmias, 2002).

- ***Flexibility***

The interview allows great flexibility in the questionnaire process, and the greater the flexibility, the less structured the interview. Some interviews allow the interviewer to determine the wording of the questions, to clarify terms that are unclear, to control the

order in which the questions are presented and to probe for additional information and details (Nachmias and Nachmias, 2002).

- ***Control over the context of response***

In contrast to self-completion questionnaires, the researcher has control over who responds to questions. By establishing good rapport, the researcher can ensure that questions are taken seriously (Aldridge and Levine, 2001).

- ***Dealing effectively with complex questions***

The presence of the researcher allows complicated questions to be explained, improving the quality of the answers and eliminating human error.

6.3.3.2 Disadvantages of the interview technique

- ***Higher cost***

The cost of interview studies is significantly higher than that of mail surveys. Costs are involved in selecting, training, and supervising interviewers; in paying them; and in the travel and time required to conduct interviews. Moreover, the cost of recording and processing the information obtained in nonstructured interviews is especially high (Nachmias and Nachmias, 2002).

- ***Lack of anonymity***

If the subject matter of the interview is delicate or controversial, a face-to-face interview may be threatening to some respondents. Even if confidentiality and anonymity are

assured, the answers still have to be spoken, and some respondents may be reluctant to say what they feel (Hibberd and Bennett, 1990).

- ***Interviewer bias***

Interviewers can introduce bias by offering unauthorised comments on the questions, the research or the interviewee, which can lead the respondent in a particular direction (Aldridge and Levine, 2001). The lack of standardisation in the data collection process also makes interviewing highly vulnerable to interviewer bias. Although interviewers are instructed to remain objective and to avoid communicating personal views, they usually give cues that may influence the respondent's answers. Even when verbal cues are avoided, the interviewer may fail to control nonverbal communication. Sometimes, even the interviewer's race or gender can influence respondents, who may give socially admirable but potentially misleading answers because they are to please the interviewer (Nachmias and Nachmias, 2002).

6.3.3.3 The justifications of using the interview technique

The interview technique has been adopted in this study because it will help to overcome the problem of validity and reliability. The personal interview technique provides more valid and reliable data than other technique (validity and reliability will be discussed later in this chapter). Moreover, the results from the interviews will confirm and strengthen the results from the questionnaire and the single case study.

Additionally, by interviewing well-experienced businessmen who have taken their companies public, the research in this study would be able to gather very essential data

regarding the real motivations for going public, the real barriers they faced, the real effects of the going public on their companies.

6.3.3.4 The interviewees

Two groups of people were interviewed. The first group was the CEO and the Financial Manager of the company that provided the researcher with the necessary documents (a single case study). The second group was three managers and owners of IPOs in Saudi Arabia. The second group was willing to give interviews, but did not provide any documentation about their companies. These three businessmen are:

1. Dr. Abdulrahman A. Al-Zamil, one of the owners and the chairman of the Al-Zamil Group. He was the deputy Commerce Minister and is now a member of the Saudi Shura Council (Parliament). He has taken his company public in 1998 after floating 40% of its shares.
2. Mr. Sulaiman A. Al-Rajhi[28]. His bank went public in 1988.
3. Mr. Khalid Al-Rabiaah, the general manager for administration and finance in the Saudi Arabian Amiantit Company, which converted to a Saudi Joint Stock Company in January 1994.

6.4 Validity and reliability

Generally speaking, research projects should give great attention to reliability and validity. Whatever procedure for collecting data is selected, it should always be tested critically to assess, to what extent it is likely to be valid and reliable. A reliable

[28] According to Forbes Magazine in 2003, Al-Rajhi was number 192 in the list of the world's richest people and number 7 of Saudi's richest people.

measurement is one where the researchers obtain the same result on repeated occasions. If the same respondents answer a question the same way on repeated occasions then it is reliable (De Vaus, 1996). Validity refers to the extent to which a test measures what researchers actually wish to measure (Alarfaj, 1996). In other words, validity is concerned with whether the researchers are measuring the right concept or not. It is the ability of a research instrument to measure what it is supposed to measure (Cooper and Emory, 1995)

The following sub-sections discuss the appropriate measures taken to ensure that validity and reliability were properly addressed during both data collection and data analysis.

6.4.1 Validity

Researchers have many types of validity available to test how good the measures are. However, content validity, construct validity, and criterion-related validity are the three major types of measurement that most researchers are concerned with (Alarfaj, 1996).

6.4.1.1 Content validity

Content validity is concern with ensuring that the measure contains a sufficient and representative set of the topic under study. The researcher may determine content validity via careful definition of the research topic, the items to be scaled, and the scale to be used. According to Emory (1985), this logical process is, to some extent, intuitive and is unique to every research designer.

6.4.1.2 Criterion-related validity

Literally, criterion-related validity measures how well a set of scores obtained from a particular measurement procedure relates to a chosen criterion (Suen and Ary, 1989). Criterion-related validity is estimated empirically and quantitatively through a statistical correlation between the set of scores obtained from a measurement procedure with those obtained from an alternative method of measuring the criterion (Suen and Ary, 1989).

6.4.1.3 Construct validity

Construct validity is established by relating a measuring instrument to a general theoretical order to determine whether the instrument is tied to the concepts and the theoretical assumptions which the researcher is employing (Nachmias and Nachmias, 2002).

Finally, the researcher believes that the validity of this study has been accomplished because of using several techniques. These techniques were:

1. The questionnaire survey, interviews, and the single case study cover the essential points which the literature review identified.
2. The questionnaire was tested, revised, and improved based on the opinions of ten of the researcher's colleagues at King Faisal University, Saudi Arabia, six Accounting and Finance PhD students at the University of Newcastle upon Tyne, UK, and Oklahoma State University, USA, and also eight Saudi businessmen.

3. The questionnaire was as clear and simple as it could be. The participants were given space after each main question in the questionnaire giving them the freedom to add more points.
4. The researcher in this study conducted a single case study. Firstly, the researcher tested and analysed the financial statements of a Saudi company, which switched from being a limited liability company to a joint stock company, for a ten-year period. Secondly, interviews were conducted with the CEO and the financial manager of that company.
5. The researcher conducted personal interviews with three CEOs and owners of IPOs. The main research questions were discussed. This methodology was used as a second data-gathering instrument which increased the validity of this research.
6. The results from the questionnaires were very close to the results obtained from interviews, indicating a strong degree of validity.
7. As will be shown in the discussion chapter (Chapter Nine), the majority of results of this research were supported by the findings of other research.

6.4.2 Reliability

Even reliability is a contributor and necessity for validity. It is not, however, a sufficient condition of validity. Reliable instruments are robust and work well at different times under different conditions. This distinction of time and condition is the basis for two frequently used perspectives on reliability: stability[29] and equivalence[30] (Cooper and Emory, 1995). Therefore, while stability is concerned with personal and situational

[29] A measure is said to be stable if it can secure consistent results with repeated measurements of the same person with the same instrument.
[30] A second perspective on reliability considers how much error may be introduced by different investigators (in observation) or different samples of items being studied (in questioning).

fluctuations from one to another, equivalence is concerned with variations at one point in time among observers and a sample of items (Emory, 1980). A question may be unreliable because of bad wording, and different interviewers can elicit different answers from respondents (De Vaus, 1996). There are three usually used ways of testing reliability (Nachmias and Nachmias, 2002):

6.4.2.1 The test-retest method

The test-retest method estimates reliability by asking the same questions at intervals of a few weeks and calculating the correlation between the answers on both occasions. If the correlation is very high then the researchers can assume that the questions are reliable. However, it is usually difficult to give the same test to the same respondents twice and respondents may remember their answers from the first occasion and, therefore, choose the same answers on the second occasion, making this test poor.

6.4.2.2 The parallel-form method

Researchers need to develop two parallel versions of a measuring instrument. Both versions should be given to the same group of participants. The researchers then calculate the correlation between the answers obtained from both groups. The higher the correlation, the more reliable the questions are. Researchers using this technique may find some difficulties to determining whether or not the two versions of their instrument are in reality parallel.

6.4.2.3 The split-half method

Reliability in this method is estimated by treating each of two or more parts of a measuring instrument as a separate scale. Each of the two parts is treated separately and scored accordingly. The researchers then calculate the correlation between the answers obtained from these parts. The higher the correlation, the more reliable the questions are.

Due to the disadvantages these methods have, and the difficulties of implementing them, the researcher in this study used another technique to test the reliability of the questionnaire survey. The researcher added similar questions to the questionnaire. The researcher constructed some of the questions in the questionnaire so that, if the instrument was reliable, similar answers would be obtained. For example, the answers for Question 10-a-1, and 10-a-2 should be consistent with each other, if the test is reliable. Similarly the answers for Questions 15-a, 15-b, 15-c, 15-d, 15-e, 15-f, and 15-g should be consistent with each other. The answers for Question 10-d-1 should contradicted the answers for 11-d-1.

In addition, it is believed that one of the best ways to increase reliability is to use multiple-item indicators because they are more reliable, and researchers have easier methods of assessing their reliability (De Vaus, 1996). The researcher, in this study, used a 5-point Likert Scale in most of the major questions, creating multiple-item indicators.

6.5 Summary

The purpose of this chapter has been to expose and rationalise the methodology employed in this research. The research phases were elucidated and identified.

One of the main aims of this chapter was to discuss and examine the research methods adopted in similar studies. Primary and secondary data were identified and the advantages and disadvantages of both kinds of data were discussed.

Another aim of this chapter was to present data collection techniques used in this research. For many reasons, the decision was made to collect the required data by using a single case study, posted questionnaire, and interviews. The justifications, the advantages and disadvantages of using these three techniques were discussed.

Furthermore, this chapter attempted to shed further light on the techniques adopted to increase the response rate, such as a follow up letter, and the sponsorship of a questionnaire. The questionnaire design was also discussed. The questionnaire in this study consisted of seventeen questions distributed in five sections. The pilot study, the population and the sample selected of the questionnaire, the statistical tests used to analyse the questionnaire data were presented.

The validity and reliability of this study were discussed in some depth in the last section. Finally, this section showed that the researcher in this study was able to boost the reliability and validity and strengthen the results and findings of this research by using three data collection methods.

Chapter Seven: The case study - comparative financial analysis between the years before and after the IPO

7.1 Introduction

As discussed in the methodology, Chapter 6, one of the ways to find answers to research questions is by studying a real case, here an IPO in Saudi Arabia. Only one company was willing to co-operate with the researcher and provide the necessary documents. However, the company officials asked the researcher to keep their identities and the name of the company confidential. The researcher accepted the condition of anonymity, understanding the sensitivity of the action of going public, and the attitude of business people in the Kingdom towards revealing too much detail. Because of the small number of IPOs in the Kingdom, little information about the company is presented, making the corporate strategy investigation unfeasible.

The distinguish of this chapter is that it will find empirically the actual reasons for the IPO, and the actual effects of the IPO on the financial statements by employing financial ratio technique. As has been mention in Chapter Six ratios alone are not a complete answer to assessing performance, but they provide the analyst with guidelines for asking the right questions to discover areas requiring more investigation to establish the full picture of company performance. Moreover, it could be argued that ratio analysis technique is not reliable if it is not compared with the industry standard. Because of the lack of data for Saudi Arabian industries, the researcher will make further investigations

to confirm the findings from the financial analysis by conducting in-depth interviews with the company's officials.

This chapter consists of three parts. The first part provides information about the company. The second part is an analysis of the balance sheet, profits and losses, and cash flow statements of the company, using the technique of financial ratio analysis. The third part contains the answers to questions asked during the interviews with the senior company officials.

7.2 Company information

7.2.1 Background

The company was established in the 1970s as a limited liability company and went public in 1988. The company operates locally and internationally. The company's customers are:

- ***Government bodies:*** they represent approximately 50% of its customers. These government bodies release tenders for their direct purchase requirements on a regular basis.
- ***Major projects and contractors:*** they represent approximately 30% of its clients and include some of the largest construction companies operating in Saudi Arabia.
- ***Retail:*** medium-sized and small contractors and other local retail customers represent about 10% of the customers.

- ***Export:*** the company has been successful in exporting its products to over 15 countries including Turkey, Ireland, Algeria, Greece, Egypt, India, and Pakistan, and exporting is responsible for 10% of its sales.

7.2.2 The initial public offering process

The company was supported by the Saudi Industrial Development Fund (SIDF)[31]. The terms of the SIDF agreement required the company to become a joint stock company. The company reached an understanding with the SIDF and Ministry of Commerce to become a joint stock company and expand its shareholder base. In addition, the company believed that the money raised would provide additional capital for the company's expansion.

At the beginning of 1987, the capital of the company was SR 200,000,000 divided into 2,000,000 shares. On 19 March 1987, the shareholders decided to increase the share capital of the company by 150,000 shares of SR 100 each, by the capitalisation of retained earnings. At the end of 1987, the company offered its shares to the public. A prospectus was issued for the sale of a total of 1,075,000 shares (550,000 new and 525,000 existing shares) at SR 100 each. Therefore, the capital was increased from SR 215,000,000 to SR 270,000,000, and the actual money raised from the IPO was SR 55,000,000. After the IPO, the original shareholders' retention of the total share capital was approximately 60%. At the beginning of 1988, the company was converted officially into a joint stock company, and in June 1991 all the company shares, including the

[31] The SIDF was established by the Saudi government in 1974 to provide long-term loans for the private sector's industrial projects. It provides technical advisory services and marketing assistance to such projects. Moreover, the SIDF provides interest free loans, except for an administrative cost of 2.5% of the value of the loan, with complete government finance

original founders' shares, became freely tradable on the SSM. In 1992 the company increased its capital to SR 300,000,000 by issuing 300,000 shares. The book value of all new issued shares was SR 100 each. A total of 270,000 shares were distributed to the shareholders as dividends, one new share for every ten shares held, and 30,000 shares were sold to the employees of the company at SR 185 each. Table 7-1 shows a summary of changes in the capital of the company up to 1992.

Table 7-1 Changes in the capital of the company up to 1992

Date	Capital	Increase in Capital	New money raised	# of shares	Increase in # of shares	# of Shares held by founders	% of shares held by founders
1/1/1987	200 Mil	None	None	2.00 Mil	None	2 Mil	100.00%
19/3/1987	215 Mil	15 Mil	15 Mil	2.15 Mil	150,000	2.15 Mil	100.00%
31/12/1987	270 Mil	55 Mil	55 Mil	2.70 Mil	550,000	1.625 Mil	60.19%
1992	300 Mil	30 Mil	32.55 Mil	3.00 Mil	300,000	N/A	N/A

7.2.3 The competition in the company's market[32]

The market for the company's products in the Kingdom grew rapidly with the development of the country's infrastructure from around SR 800 million in 1977 to go above SR 3 billion in 1983. However, the company's product market shrank because of the economic slowdown in the late 1980s and also because of the Gulf War in the 1990.

During the early years of operation, the company faced severe foreign competition from Japan and Europe. In 1984, the company proved to the Saudi Government that international competitors were selling the products into the Saudi market at price levels below material cost. The Council of Ministers consequently imposed a 20% import duty

[32] Most of the information in this section has been taken from the company's prospectus.

on the similar products that the company produced. This new imposed tariff assisted the company in increasing its market share to reach 50% of the total market.

The company's product market is characterised by strong relationships between suppliers and buyers and a high degree of customer loyalty. Being the largest firm in the region, the company is in a strong position to assist major customers with logistical problems, application techniques and quality specifications. Right now, the company faces competition from three other major Saudi companies, regional competition from Dubai, Kuwait, and Oman and other international companies.

7.2.4 Significant accounting policies before and after the IPO

It was shown previously in Chapter Six (methodology chapter) that one of the limitations of the financial ratio technique is that it does not take into account changes in accounting policies. When a researcher makes a comparative analysis of a company's financial statements over a certain period of time, appropriate allowance should be made for any changes in accounting policies that occurred during that time span, as variation in accounting policy can have a great effect on the financial ratio analysis. Accounting principles allow firms' management to have some level of discretion in summarising and reporting business activities. For example, managers have the flexibility in choosing the estimates for expected lives and salvage values of fixed assets. And, they also have the freedom to choose one from a few acceptable accounting methods for reporting the same transaction, such as LIFO or FIFO for the inventory valuation method, and the straight-line or accelerated schedule for the depreciation method. Therefore, if there are changes

in accounting policies, the researcher has to make the necessary adjustments to the financial statement or comparative statement analysis may be distorted.

Furthermore, since firms have the opportunity to manage earnings around IPO, it is important to review the changes in accounting policy. In the present study, after reviewing all the company's annual reports, it was found that the company kept the same accounting policy during the years under investigations. Some significant accounting policies are:

1. **The basis of presentation**: the financial statements include the company's share of the results and retained reserves of subsidiaries and an associated company based on their latest audited financial statements.
2. **Accounting convention**: the financial statements of the company were prepared under the historical cost convention.
3. **Depreciation and amortisation**: freehold land is not depreciated. The cost less the estimated residual value of other property, plant, and equipment is depreciated with effect from the date of purchase by equal monthly instalment over their expected useful lives.
4. **Inventories**: inventories are valued at the lower of average cost and net realisable value with due allowance for any obsolete or slow moving items.
5. **Accounts receivable**: provision is made against accounts receivable as soon as they are considered doubtful.

6. **Employees' terminal benefits**: provision is made for amounts payable under the Saudi Arabian Labour Laws applicable to employees' accumulated periods of service at the balance sheet date.
7. **Sales**: sales represent the invoiced value of goods supplied by the company during the year.
8. **Foreign Currencies**: foreign currency transactions are recorded in Saudi Riyals at the approximate rates of exchange ruling at the time of the transactions. Assets and liabilities in foreign currency at the balance sheet date are translated at the year end rates of exchange. Exchange differences are reported as part of the results for the year.
9. **Zakat**: *Zakat* in respect of the company is provided for in accordance with Saudi Arabian fiscal regulations. The liabilities, which is 2.5%, are charged to the profit and loss account (for more information about Zakat, please see Chapter Four).

7.2.5 The general economic situation before and after the IPO

Because the company's performance could be affected by the general Saudi economic situation before, at the time of, and after the IPO, it is worth here to review this subject. Chapter Two discussed the general economic background of Saudi Arabia in some depth. This chapter shows that the Saudi economy in the 1980s and early 1990s was affected by some unexpected factors. Firstly, there was the First Gulf War, which started in 1980 and ended in 1988. This was associated with a drop in oil prices. Because of this, Saudi Arabia had its first budget deficit in 1983. Since then, it has run a persistent deficit. The government succeeded in reducing the deficit during the five-year period before Iraq

invaded Kuwait in August 1990. During the second half of the 1980s, Saudi Arabia cut its overall budget deficit by more than half, from over 20% of Gross National Product (GNP) to less than 10% (Ministry of Planning, 2003). Secondly, there was the Second Gulf War, which started in 1990 and ended in 1991. Because of the Second Gulf War, the average budget deficit for the years 1990 and 1991 came to about 17% of GDP. The Kuwait crisis cost the country some $55 billion - $69 billion (Business Monitor International Ltd., 1993). The problem of the budget deficit was exacerbated by a loss of a major part of the reserve, caused by the Second Gulf War. Liquid funds available to the SAMA were at a fraction over $7 billion, and were unlikely to show much, if any, improvement in the short to medium term.

7.3 Results of financial ratio analysis

The financial reports of the company show that the effects of the decision to go public began at the end of 1987 when the company increased its capital by SR 55,000,000. Therefore, 1988 was taken as the year zero of going public.

To make a fair comparison between the period before the IPO and the period after the IPO, the years of 1983, 1984, 1985, 1986, and 1987 were analysed and considered to be the years before the IPO and the years of 1988, 1989, 1990, 1991, and 1992 were also analysed and considered to be the years after the IPO. The researcher believes that five years before and five years after the IPO should be fair enough to measure the changes in the performance of the company and eliminate either external or internal unusual factors which might affect the operation of the company. It should be said here the inflation in

Saudi Arabia in the period under investigation was stable (for more information about the inflation and the general economic situation, please see Chapter Two).

Table 7-2 The financial ratios of the company from 1983 to 1992

Ratios	Period before IPO							Period after IPO						
	1983	1984	1985	1986	1987	Mean	Median	1988	1989	1990	1991	1992	Mean	Median
Profitability														
Gross profit margin	23.22%	17.95%	18.50%	16.16%	13.45%	**17.86%**	**17.95%**	9.34%	9.30%	9.80%	11.77%	13.11%	**10.67%**	**9.80%**
Net profit margin	15.37%	2.41%	4.12%	2.06%	2.39%	**5.27%**	**2.41%**	1.92%	4.15%	0.30%	4.06%	5.37%	**3.16%**	**4.06%**
Return on assets	14.83%	1.66%	3.05%	1.68%	1.51%	**4.55%**	**1.68%**	1.56%	3.84%	0.27%	3.33%	3.86%	**2.57%**	**3.33%**
Return on equity	35.68%	4.60%	9.12%	4.86%	4.18%	**11.69%**	**4.86%**	4.24%	10.70%	0.72%	8.87%	9.84%	**6.87%**	**8.87%**
Operating ROA	13.62%	5.31%	6.88%	6.86%	4.76%	**7.49%**	**6.86%**	3.64%	4.77%	4.67%	5.75%	6.10%	**4.99%**	**4.77%**
Operating ROS	14.12%	7.68%	9.30%	8.41%	7.52%	**9.41%**	**8.41%**	4.47%	5.16%	5.18%	7.01%	8.49%	**6.06%**	**5.18%**
Operating ROE	32.77%	14.65%	20.58%	19.82%	13.14%	**20.19%**	**19.82%**	9.89%	13.30%	12.40%	15.31%	15.56%	**13.29%**	**13.30%**
Growth														
Growth of sales	57.0%	-15.7%	24.9%	7.2%	5.0%	**15.67%**	**7.16%**	26.9%	25.3%	-6.7%	0.1%	-9.7%	**7.21%**	**0.13%**
Liquidity ratios														
Current Ratio	2.19	1.77	1.54	2.22	1.90	**1.92**	**1.90**	1.57	1.25	1.14	1.36	1.19	**1.30**	**1.25**
Quick ratio	1.31	0.99	0.68	1.53	1.34	**1.17**	**1.31**	1.00	0.88	0.69	0.83	0.68	**0.82**	**0.83**
Cash ratio	0.02	0.04	0.01	0.04	0.43	**0.11**	**0.04**	0.18	0.18	0.13	0.12	0.05	**0.13**	**0.13**
Operating Cash Flow	0.63	0.13	0.18	0.24	0.13	**0.26**	**0.18**	0.06	0.10	0.00	0.09	-0.04	**0.05**	**0.06**
NWC to Assets.	33.09%	25.08%	18.66%	28.46%	30.33%	**27.12%**	**28.46%**	18.15%	9.95%	6.46%	15.04%	8.89%	**11.70%**	**9.95%**
Interest coverage (earning basis)	7.53	1.52	2.02	1.49	1.60	**2.83**	**1.60**	1.60	2.38	1.08	2.23	2.80	**2.02**	**2.23**
Interest coverage (C.F. basis)	8.68	2.36	3.06	2.33	2.70	**3.83**	**2.70**	1.89	2.40	1.06	2.38	0.22	**1.59**	**1.89**
Long-term Debt ratios														
Total debt ratio	58.4%	63.8%	66.6%	65.4%	63.8%	**63.59%**	**63.77%**	63.2%	64.2%	62.4%	62.4%	60.8%	**62.58%**	**62.42%**
Long-term debt to equity ratio	0.74	0.86	0.96	1.21	0.83	**0.92**	**0.86**	0.85	0.68	0.47	0.55	0.38	**0.59**	**0.55**
Long-term debt to assets ratio	30.64%	31.27%	31.97%	42.03%	30.24%	**33.23%**	**31.27%**	31.22%	24.45%	17.66%	20.83%	14.95%	**21.82%**	**20.83%**
Turnover ratios														
Inventory turnover	3.02	2.22	2.04	4.26	2.87	**2.88**	**2.87**	4.10	5.59	3.88	3.16	2.65	**3.88**	**3.88**
Inventory Period	120.71	164.27	179.27	85.77	127.04	**135.41**	**127.04**	89.02	65.29	94.01	115.44	137.57	**100.27**	**94.01**
Receivables turnover	2.69	2.24	3.17	2.66	2.41	**2.64**	**2.66**	3.20	3.69	4.30	3.43	3.60	**3.64**	**3.60**
Receivables Period	135.59	162.90	115.16	137.16	151.31	**140.42**	**137.16**	114.11	98.80	84.88	106.38	101.46	**101.13**	**101.46**
Operating cycle	256.30	327.17	294.43	222.94	278.35	**275.84**	**278.35**	203.13	164.09	178.90	221.82	239.03	**201.39**	**203.13**
Payables turnover	6.23	7.20	6.42	6.85	3.35	**6.01**	**6.42**	6.58	6.29	7.81	4.39	5.38	**6.09**	**6.29**
Payables period	58.58	50.73	56.86	53.27	108.91	**65.67**	**56.86**	55.46	58.02	46.74	83.11	67.87	**62.24**	**58.02**
Cash cycle	197.72	276.45	237.57	169.67	169.44	**210.17**	**197.72**	147.67	106.06	132.16	138.71	171.16	**139.15**	**138.71**
NWC turnover	2.92	2.76	3.96	2.87	2.09	**2.92**	**2.87**	4.49	9.29	13.95	5.46	8.08	**8.25**	**8.08**
Fixed asset turnover	2.47	1.63	1.58	1.69	1.75	**1.82**	**1.69**	1.63	1.84	1.84	1.89	1.59	**1.76**	**1.84**
Total asst turnover	0.96	0.69	0.74	0.82	0.63	**0.77**	**0.74**	0.82	0.92	0.90	0.82	0.72	**0.84**	**0.82**

Table 7-3 Balance sheet from 1982 to 1992 (thousands SR)

Items	Period before IPO								Period after IPO						
	1982	1983	1984	1985	1986	1987	Mean	Median	1988	1989	1990	1991	1992	Mean	Median
Cash and bank balances	1,617	2,699	7,214	2,348	6,446	132,338	25,444	4,573	52,453	69,930	57,172	54,481	24,001	51,607	54,481
Accounts receivable and payments	87,777	181,782	184,058	162,561	207,500	240,267	177,324	182,920	230,022	249,545	200,138	251,167	216,297	229,434	230,022
Amounts due from affiliates	0	0	0	0	27,990	37,640	10,938	0	6,698	27,720	37,534	55,545	98,132	45,126	37,534
Inventories	97,723	124,258	152,297	206,250	108,787	174,583	143,983	138,278	162,676	148,218	194,039	233,456	254,717	198,621	194,039
Total current assets	**187,117**	**308,739**	**343,570**	**371,160**	**350,724**	**584,829**	**357,690**	**347,147**	**451,849**	**495,413**	**488,883**	**594,649**	**593,147**	**524,788**	**495,413**
Long term receivable from subsidiary company	0	0	0	0	0	6,495	1,083	0	32,672	39,396	21,815	15,231	46,066	31,036	32,672
investment in subsidiaries & associates	10,380	10,380	11,970	9,492	17,488	26,585	14,383	11,175	37,085	59,676	69,666	81,683	84,769	66,576	69,666
Other investment	0	0	0	0	0	0	0	0	21,110	29,926	34,680	38,125	38,375	32,443	34,680
Deferred charges	14,269	21,355	24,319	35,337	33,929	29,897	26,518	27,108	31,232	37,367	32,989	26,842	34,107	32,507	32,989
Property, plant and equipment	114,838	166,723	216,875	280,739	274,643	268,181	220,333	242,528	328,099	335,485	307,540	293,588	287,236	310,390	307,540
Total Fixed Assets	**139,487**	**198,458**	**253,164**	**325,569**	**326,061**	**331,158**	**262,316**	**289,367**	**450,198**	**501,850**	**466,690**	**455,469**	**490,553**	**472,952**	**466,690**
Total assets	**326,604**	**507,197**	**596,735**	**696,730**	**676,786**	**915,988**	**620,007**	**636,761**	**902,047**	**997,263**	**955,573**	**1,050,118**	**1,083,700**	**997,740**	**997,263**
Accounts payable & accruals	48,714	60,298	37,229	49,945	59,105	134,314	64,934	54,525	88,932	125,522	88,524	156,481	114,988	114,889	114,988
Amounts payable to affiliates	0	0	0	0	195	8,623	1,470	0	7,924	4,086	5,687	25,864	3,667	9,446	5,687
Short term bank loan & overdrafts	22,866	65,998	116,501	132,470	38,136	109,400	80,895	87,699	112,500	195,277	234,779	220,224	279,651	208,486	220,224
Current portion of term loans	9,831	14,620	25,806	38,636	52,223	39,333	30,075	32,221	66,338	65,139	90,265	22,525	72,843	63,422	66,338
Advances from customers	0	0	9,798	15,470	8,453	15,353	8,179	9,126	12,416	6,199	7,938	11,601	10,680	9,767	10,680
Proposed dividends	0	0	4,584	4,634	0	0	1,536	0	0	0	0	0	15,000	3,000	0
Total current liabilities	**81,411**	**140,916**	**193,920**	**241,157**	**158,114**	**307,025**	**187,091**	**176,017**	**288,110**	**396,223**	**427,193**	**436,695**	**496,829**	**409,010**	**427,193**
Long term loans	115,081	149,790	178,496	212,981	274,385	264,444	199,196	195,739	266,402	226,519	151,581	198,958	139,603	196,613	198,958
Employees terminal benefits	3,820	5,628	8,103	9,780	10,091	12,592	8,336	8,942	15,191	17,426	17,130	19,780	22,416	18,389	17,426
Total long term liabilities	**118,901**	**155,418**	**186,600**	**222,761**	**284,476**	**277,036**	**207,532**	**204,681**	**281,593**	**243,945**	**168,711**	**218,738**	**162,019**	**215,001**	**218,738**
Total liabilities	**200,312**	**296,334**	**380,520**	**463,919**	**442,590**	**584,062**	**394,623**	**411,555**	**569,703**	**640,168**	**595,904**	**655,433**	**658,848**	**624,011**	**640,168**
Share capital	70,000	200,000	200,000	200,000	200,000	270,000	190,000	200,000	270,000	270,000	270,000	270,000	300,000	276,000	270,000
Share premium account	0	0	0	0	0	41,370	6,895	0	0	0	0	0	0	0	0
Proposed increase in share capital	0	0	0	0	0	0	0	0	0	0	0	27,000	0	5,400	0
Statutory reserve	5,951	8,950	9,944	12,067	13,429	14,865	10,868	11,006	55,671	57,517	59,861	63,503	68,154	60,941	59,861
Retained earnings	50,341	1,913	6,270	20,743	20,766	5,690	17,621	13,507	6,673	29,938	29,808	34,182	56,698	31,460	29,938
Total Equity	**126,292**	**210,863**	**216,214**	**232,811**	**234,195**	**331,926**	**225,384**	**224,513**	**332,344**	**357,455**	**359,669**	**394,685**	**424,852**	**373,801**	**359,669**
Total Equity & Liabilities	**326,604**	**507,197**	**596,735**	**696,730**	**676,786**	**915,988**	**620,007**	**636,761**	**902,047**	**997,623**	**955,573**	**1,050,118**	**1,083,700**	**997,812**	**997,623**

Table 7-4 Income statement from 1982 to 1992 (thousands SR)

Items	Period before IPO								Period after IPO						
	1982	1983	1984	1985	1986	1987	Mean	Median	1988	1989	1990	1991	1992	Mean	Median
Sales	311,671	489,357	412,406	515,253	552,170	579,589	476,741	502,305	735,760	921,948	860,616	861,765	778,120	831,642	860,616
Cost of sales	-244,281	-375,727	-338,396	-419,935	-462,927	-501,615	-390,480	-397,831	-667,024	-828,590	-753,337	-738,139	-675,803	-732,579	-738,139
Customers duty& Iraq receivables	0	0	0	0	0	0	0	0	0	-7,608	-22,899	-22,190	-300	-10,599	-7,608
Gross profit	**67,390**	**113,630**	**74,009**	**95,318**	**89,242**	**77,974**	**86,261**	**83,608**	**68,736**	**85,750**	**84,380**	**101,436**	**102,017**	**88,464**	**85,750**
Other income	87	485	214	91	670	566	352	350	43	1,193	158	0	0	279	43
Total income	**67,477**	**114,115**	**74,223**	**95,410**	**89,913**	**78,540**	**86,613**	**84,227**	**68,779**	**86,943**	**84,538**	**101,436**	**102,017**	**88,743**	**86,943**
Administration & selling expenses	-30,520	-45,025	-42,540	-47,505	-43,493	-34,927	-40,668	-43,017	-35,903	-39,398	-39,933	-41,018	-35,929	-38,436	-39,398
Financial charges	-7,654	-11,528	-18,976	-20,849	-28,014	-24,132	-18,526	-19,913	-21,042	-28,493	-31,912	-29,578	-23,872	-26,979	-28,493
Amortisation of deferred charges	-2,400	-3,776	-2,772	-3,346	-4,782	-5,120	-3,699	-3,561	-4,576	-4,195	-6,180	-6,147	-5,845	-5,389	-5,845
Profit before zakat & unusual expenses	**26,903**	**53,786**	**9,935**	**23,709**	**13,621**	**14,360**	**23,719**	**19,035**	**7,258**	**14,857**	**6,513**	**24,693**	**36,371**	**17,938**	**14,857**
Unusual expense	0	21,443	0	-2,478	0	0	3,161	0	2,138	0	0	0	0	428	0
Share of profit/(loss) of subsidiaries & associates	0	0	0	0	0	0	0	0	3,234	24,466	-3,939	11,722	6,536	8,404	6,536
Profit before zakat	**26,903**	**75,229**	**9,935**	**21,231**	**13,621**	**14,360**	**26,880**	**17,796**	**12,630**	**39,323**	**2,574**	**36,415**	**42,907**	**26,770**	**36,415**
Zakat	0	0	0	0	-2,237	-500	-456	0	1,468	-1,072	0	-1,399	-1,100	-421	-1,072
Net Profit	**26,903**	**75,229**	**9,935**	**21,231**	**11,384**	**13,860**	**26,424**	**17,546**	**14,098**	**38,251**	**2,574**	**35,016**	**41,807**	**26,349**	**35,016**
Statement of retained earnings:															
Balance at the beginning of the year	0	0	1,913	6,270	20,743	20,766	8,282	4,092	7,281	6,673	29,938	29,808	34,182	21,576	29,808
Profit for the year	0	0	9,935	21,231	11,384	13,860	9,402	10,660	14,098	38,251	2,574	35,016	41,807	26,349	35,016
Total Profit	**0**	**0**	**11,848**	**27,502**	**32,128**	**34,626**	**17,684**	**19,675**	**21,379**	**44,924**	**32,512**	**64,824**	**75,989**	**47,926**	**44,924**
Transfer to statutory reserve	0	0	-993	-2,123	-1,362	-1,436	-986	-1,178	-1,206	-1,486	-2,704	-3,642	-4,291	-2,666	-2,704
Dividends proposed	0	0	-4,584	-4,634	-10,000	-12,500	-5,286	-4,609	-13,500	-13,500	0	-27,000	-15,000	-13,800	-13,500
Transfer to proposed increase in share capital	0	0	0	0	0	-15,000	-2,500	0	0	0	0	0	0	0	0
Balance at the end of the year	**0**	**0**	**6,270**	**20,743**	**20,766**	**5,690**	**8,912**	**5,980**	**6,673**	**29,938**	**29,808**	**34,182**	**56,698**	**31,460**	**29,938**

Table 7-5 Cash flow statement from 1982 to 1987 (thousands SR)

Items	Period before IPO							
	1982	1983	1984	1985	1986	1987	Mean	Median
Source of funds from operations:								
Profit for the year before zakat	26,903	75,229	9,935	21,231	13,621	14,360	26,880	17,796
Depreciation	7,443	11,530	10,605	14,280	18,561	19,024	13,574	12,905
Amortisation of deferred charges	0	0	2,772	3,346	4,782	5,120	2,670	3,059
Employees terminal benefits	1,574	1,808	2,475	1,676	310	2,501	1,724	1,742
Provision for reduction in value of investment	0	0	0	2,478	0	0	413	0
Total generated from operations	**35,920**	**88,567**	**25,788**	**43,012**	**37,276**	**41,005**	**45,261**	**39,141**
Other sources:								
Shareholders' funds	0	0	0	0	0	96,370	16,062	0
Drawdown of term loans	92,388	51,000	50,840	81,315	113,317	1,502	65,060	66,158
Disposals of property, plants and equipment at net book amounts	484	5,108	541	156	169	676	1,189	513
Receipts from shareholders	16,115	0	0	0	0	0	2,686	0
Total sources of funds	**144,907**	**144,675**	**77,169**	**124,483**	**150,762**	**139,555**	**130,259**	**142,115**
Funds Applied:								
Purchase of property, plant and equipment	52,216	55,433	61,298	78,301	12,634	13,238	45,520	53,825
Deferred charges	10,779	5,066	5,736	14,364	3,374	1,087	6,734	5,401
Investment	10,380	0	1,590	0	7,996	9,096	4,844	4,793
Zakat	0	0	0	0	3,476	333	635	0
Repayments of term loans	24,947	11,503	10,946	33,999	38,326	24,333	24,009	24,640
Dividends	572	2,157	5,767	4,584	4,158	5,143	3,730	4,371
Long term loan to an affiliate	0	0	0	0	0	6,495	1,083	0
Total applications of funds	**98,894**	**74,159**	**85,339**	**131,249**	**69,966**	**59,728**	**86,556**	**79,749**
Increase in working capital	**46,013**	**70,516**	**-8,170**	**-6,766**	**80,796**	**79,826**	**43,703**	**58,265**

Table 7-6 Cash flow from statement from 1988 to 1992 (thousands SR)

Items	Period after IPO						
	1988	1989	1990	1991	1992	Mean	Median
Cash Flow from operating activities							
Net Profit for the year	14,098	38,251	2,574	35,016	41,807	26,349	35,016
Adjustments to reconcile profit for the year to net cash provided from operating activities:							
Depreciation and amortisation	23,553	22,742	30,374	31,281	30,816	27,753	30,374
Employees terminal benefits	2,598	2,235	-296	2,650	2,636	1,965	2,598
Loss/profit from selling property, plant, & equip..	0	-1,193	0	21	303	-174	0
Share of (profit)/loss from subsidiaries and associates	-3,234	-24,466	3,939	-11,722	-6,536	-8,404	-6,536
Dividends from associated company	186	1,875	5,354	286	3,450	2,230	1,875
(Increase)/Decrease in accounts receivables	18,631	-40,545	39,593	-69,040	-5,141	-11,300	-5,141
(Increase)/Decrease in inventory	11,908	14,458	-45,821	-39,417	-21,261	-16,027	-21,261
(Increase)/Decrease in accounts payable	-46,082	32,753	-35,397	88,134	-63,690	-4,856	-35,397
(Increase)/Decrease in advances from customers	-2,938	-6,217	1,739	3,663	-921	-935	-921
Net cash provided from operating activities	**18,720**	**39,893**	**2,059**	**40,872**	**-18,537**	**16,601**	**18,720**
Cash flows used in investing activities:							
Payments for purchase of property, plant and equipment	-78,938	-30,047	-10,706	-13,954	-20,630	-30,855	-20,630
Net book amounts of property, plant and equipment disposals	43	5,307	14,457	2,772	1,708	4,857	2,772
Purchase of investments	-26,971	-8,816	-1,411	-4,026	-250	-8,295	-4,026
Payment for Deferred charges	-5,911	-10,330	-1,802	0	-13,110	-6,231	-5,911
Net cash provided from / (used in) investing activities	**-111,777**	**-43,886**	**538**	**-15,208**	**-32,282**	**-40,523**	**-32,282**
Cash flows from financing activities:							
(Repayment of) / proceeds from short term bank loans and overdrafts	3,099	82,777	39,502	-14,555	59,427	34,050	39,502
Payments to settle debts	-39,333	-66,339	-49,812	-20,363	-25,110	-40,191	-39,333
Movement on long term receivables from subsidiaries	-3,621	-6,724	-5,045	6,584	-30,835	-7,928	-5,045
Dividends	-13,500	-13,500	0	0	0	-5,400	0
Portion of Issuing shares	-1,771	0	0	0	784	-197	0
repayment of long term loans	68,297	25,256	0	0	16,073	21,925	16,073
Net cash provided from / (used in) financing activities	**13,171**	**21,470**	**-15,355**	**-28,334**	**20,339**	**2,258**	**13,171**
Net change in cash and bank balances	**-79,886**	**17,477**	**-12,758**	**-2,691**	**-30,480**	**-21,668**	**-12,758**
Cash and bank balances at 1 January	132,339	52,453	69,930	57,172	54,481	73,275	57,172
Cash and bank balances at 31 December	**52,453**	**69,930**	**57,172**	**54,481**	**24,001**	**51,607**	**54,481**

Table 7-7 The growth in the balance sheet

Items	Period before IPO							Period after IPO							0 to +5*	-5 to +5*
	1983	1984	1985	1986	1987	Mean	Median	1988	1989	1990	1991	1992	Mean	Median		
Cash and bank balances	66.9%	167.3%	-67.5%	174.5%	1953.0%	458.8%	167.3%	-60.4%	33.3%	-18.2%	-4.7%	-55.9%	-21.2%	-18.2%	-54.2%	789.3%
Cash and bank balances	66 9%	167.3%	-67.5%	174.5%	1953.0%	458.8%	167.3%	-60 4%	33.3%	-18.2%	-4.7%	-55.9%	-21.2%	-18.2%	-54.2%	789.3%
Accounts receivable	107.1%	1.3%	-11.7%	27 6%	15.8%	28.0%	15.8%	-4.3%	8.5%	-19.8%	25.5%	-13.9%	-0.8%	-4.3%	-5.9%	19.0%
Inventories	27.2%	22.6%	35.4%	-47.3%	60.5%	19.6%	27.2%	-6.8%	-8.9%	30.9%	20.3%	9.1%	8.9%	9.1%	56.5%	105.0%
Total current assets	**65.0%**	**11.3%**	**8.0%**	**-5.5%**	**66.7%**	**29.1%**	**11.3%**	**-22.7%**	**9.6%**	**-1.3%**	**21.6%**	**-0.3%**	**1.3%**	**-0.3%**	**31.2%**	**92.1%**
investment in subsidiaries & associates	**0.0%**	**15.3%**	**-20.7%**	**84.2%**	**52.0%**	**26.1%**	**15.3%**	**39.5%**	**60.9%**	**16.7%**	**17.2%**	**3.8%**	**27.6%**	**17.2%**	**128.5%**	**716.7%**
Deferred charges	49.7%	13.9%	45.3%	-4.0%	-11.9%	18.6%	13.9%	4.5%	19.6%	-11.7%	-18.6%	27.1%	4.1%	4.5%	9.2%	59.7%
Property, plant and equipment	45.2%	30.1%	29.4%	-2.2%	-2.4%	20.0%	29.4%	22.3%	2.3%	-8.3%	-4.5%	-2.2%	1.9%	-2.2%	-12.4%	72.3%
Total Fixed Assets	**42.3%**	**27.6%**	**28.6%**	**0.2%**	**1.6%**	**20.0%**	**27.6%**	**35.9%**	**11.5%**	**-7.0%**	**-2.4%**	**7.7%**	**9.1%**	**7.7%**	**8.9%**	**147.2%**
Total assets	**55.3%**	**17.7%**	**16.8%**	**-2.9%**	**35.3%**	**24.4%**	**17.7%**	**-1.5%**	**10.6%**	**-4.2%**	**9.9%**	**3.2%**	**3.6%**	**3.2%**	**20.1%**	**113.7%**
Accounts payable & accruals	23.8%	-38.3%	34.2%	18.3%	127.2%	33.0%	23.8%	-33.8%	41.1%	-29.5%	76.8%	-26.5%	5.6%	-26.5%	29.3%	90.7%
Short term bank loan & overdrafts	**188.6%**	**76.5%**	**13.7%**	**-71.2%**	**186.9%**	**78.9%**	**76.5%**	**2.8%**	**73.6%**	**20.2%**	**-6.2%**	**27.0%**	**23.4%**	**20.2%**	**148.5%**	**323.7%**
Current portion of term loans	48.7%	76.5%	49.7%	35.2%	-24.7%	37.0%	48.7%	68.7%	-1.8%	38.6%	-75.0%	223.4%	50.7%	38.6%	9.8%	398.2%
Total current liabilities	**73.1%**	**37.6%**	**24.4%**	**-34.4%**	**94.2%**	**38.9%**	**37.6%**	**-6.2%**	**37.5%**	**7.8%**	**2.2%**	**13.8%**	**11.0%**	**7.8%**	**72.4%**	**252.6%**
Long term loans	30.2%	19.2%	19.3%	28.8%	-3.6%	18.7%	19.3%	0.7%	-15.0%	-33.1%	31.3%	-29.8%	-9.1%	-15.0%	-47.6%	-6 8%
Employees terminal benefits	47.3%	44.0%	20.7%	3.2%	24.8%	28 0%	24.8%	20.6%	14.7%	-1.7%	15.5%	13.3%	12.4%	14.7%	47.5%	298.3%
Total long term liabilities	**30.7%**	**20.1%**	**19.4%**	**27.7%**	**-2.6%**	**19.0%**	**20.1%**	**1.6%**	**-13.4%**	**-30.8%**	**29.7%**	**-25.9%**	**-7.7%**	**-13.4%**	**-42.4%**	**4.2%**
Total liabilities	**47.9%**	**28.4%**	**21.9%**	**-4.6%**	**32.0%**	**25.1%**	**28.4%**	**-2.5%**	**12.4%**	**-6.9%**	**10.0%**	**0.5%**	**2.7%**	**0.5%**	**15.6%**	**122.3%**
Share capital	185.7%	0.0%	0.0%	0.0%	35.0%	44.1%	0.0%	0.0%	0 0%	0.0%	0.0%	11.1%	2.2%	0.0%	11.1%	50.0%
Statutory reserve	50.4%	11.1%	21.4%	11.3%	10.7%	20.9%	11.3%	274.5%	3.3%	4.1%	6.1%	7.3%	59.0%	6.1%	22.4%	661.5%
Retained earnings	-96.2%	227.8%	230.8%	0.1%	-72.6%	57.9%	0.1%	17.3%	348.6%	-0.4%	14.7%	65.9%	89.2%	17.3%	749.6%	2863.8%
Total Equity	**67.0%**	**2.5%**	**7.7%**	**0.6%**	**41.7%**	**23.9%**	**7.7%**	**0.1%**	**7.6%**	**0.6%**	**9.7%**	**7.6%**	**5.1%**	**7.6%**	**27.8%**	**101.5%**
Total Equity & Liabilities	**55.3%**	**17.7%**	**16.8%**	**-2.9%**	**35.3%**	**24.4%**	**17.7%**	**-1.5%**	**10.6%**	**-4.2%**	**9.9%**	**3.2%**	**3.6%**	**3.2%**	**20.1%**	**113.7%**

** 0 to +5 means the growth from 1988 to 1992, and -5 to +5 means the growth from 1983 to 1992*

Table 7-8 The growth in the income statement

Items	Period before IPO							Period after IPO							0 to +5*	-5 to +5*
	1983	1984	1985	1986	1987	Mean	Median	1988	1989	1990	1991	1992	Mean	Median		
Sales	**57.0%**	**-15.7%**	**24.9%**	**7.2%**	**5.0%**	**15.7%**	**7.2%**	**26.9%**	**25.3%**	**-6.7%**	**0.1%**	**-9.7%**	**7.2%**	**0.1%**	**5.76%**	**59.0%**
Cost of sales	53.8%	-9.9%	24.1%	10.2%	8.4%	17.3%	10.2%	33.0%	24.2%	-9.1%	-2.0%	-8.4%	7.5%	-2.0%	1.32%	79.9%
Gross profit	**68.6%**	**-34.9%**	**28.8%**	**-6.4%**	**-12.6%**	**8.7%**	**-6.4%**	**-11.8%**	**24.8%**	**-1.6%**	**20.2%**	**0.6%**	**6.4%**	**0.6%**	**48.42%**	**-10.2%**
Total income	69.1%	-35.0%	28.5%	-5.8%	-12.6%	8.8%	-5.8%	-12.4%	26.4%	-2.8%	20.0%	0.6%	6.4%	0.6%	48.33%	-10.6%
Administration & selling expenses	47.5%	-5.5%	11.7%	-8.4%	-19.7%	5.1%	-5.5%	2.8%	9.7%	1.4%	2.7%	-12.4%	0.8%	2.7%	0.07%	-20.2%
Financial charges	50.6%	64.6%	9.9%	34.4%	-13.9%	29.1%	34.4%	-12.8%	35.4%	12.0%	-7.3%	-19.3%	1.6%	-7.3%	13.45%	107.1%
Amortisation of deferred charges	57.3%	-26.6%	20.7%	42.9%	7.1%	20.3%	20.7%	-10.6%	-8.3%	47.3%	-0.5%	-4.9%	4.6%	-4.9%	27.73%	54.8%
Profit before Zakat & unusual expenses	99.9%	-81.5%	138.6%	-42.5%	5.4%	24.0%	5.4%	-49.5%	104.7%	-56.2%	279.1%	47.3%	65.1%	47.3%	401.12%	-32.4%
Profit before Zakat	179.6%	-86.8%	113.7%	-35.8%	5.4%	35.2%	5.4%	-12.0%	211.3%	-93.5%	1314.7%	17.8%	287.7%	17.8%	239.72%	-43.0%
Net Profit	**179.6%**	**-86.8%**	**113.7%**	**-46.4%**	**21.7%**	**36.4%**	**21.7%**	**1.7%**	**171.3%**	**-93.3%**	**1260.4%**	**19.4%**	**271.9%**	**19.4%**	**196.55%**	**-44.4%**

** 0 to +5 means the growth from 1988 to 1992, and -5 to +5 means the growth from 1983 to 1992*

7.3.1 Profitability ratios

Companies are usually driven by the profit motive, so it may be assumed that any decision taken is meant to improve the profitability of the firm. It has been seen in the literature review that companies justify their decision to sell a percentage of their capital to outsiders by arguing that this move would enhance their ability to grow, find new and cheaper borrowing sources, compete, etc. On this basis, a reasonable improvement in the profitability of IPOs after making the transition should be seen.

7.3.1.1 Gross profit margin (GPM)

The difference between a company's sales and the cost of those sales is gross profit. Gross profit margin is an indication of the extent to which revenues exceed direct costs associated with sales, the efficiency of operations, as well as how products are priced. It shows the percentage of net sales remaining after deducting cost of goods sold. For this company, the higher the margin, the more efficient is management's control of the cost of the merchandise. It is calculated as:

$$Gross\ profit\ margin = (sales - cost\ of\ sales / sales) * 100$$

7.3.1.2 Net profit margin (NPM)

Net profit margin, also called net profit to sales, is one of the most used ratios to assess profitability. It is computed as:

$$Net\ profit\ margin = (net\ profit\ after\ interest\ and\ tax / sales) * 100.$$

It tells how much a company generates in profit for every SR 1 in sales. Whereas, all other things being equal, higher margins are better than lower, for many firms there is a trade-off between profit margin and turnover. For example, lowering the sales price will normally increase unit volume, but profit margins will shrink. As a result, it may not be very informative to review a firm's profit margins without looking at its sales turnover.

7.3.1.3 Return on assets (ROA)

ROA is a measure of profit per dollar of assets and it is calculated as:

$$ROA = (\text{net profit after interest and tax} / \text{total assets}) * 100$$

There are criticisms of this ratio because it compares the net profit to assets after interest is paid to creditors. Because these creditors provide the means by which part of the total assets are supported, there is a fallacy of omission (Horne, 1995). ROA is not preferable when the financial charges are significant.

7.3.1.4 Return on equity (ROE)

The ROE measures the profitability from the point of view of shareholders' capital. It measures the relationship between the net profit attributable to the total equity, expressed as a percentage. It is computed as:

$$ROE = (\text{net profit after interest and tax} / \text{total equity}) * 100$$

A high figure is regarded as a good performance, and will usually result in a high share price, which enables the company to attract capital at a low cost. This facilitates growth

in a firm, given suitable market conditions, and this in turn leads to continued growth in profits. This leads to high value and continued growth in the wealth of its owners (Walsh, 1996).

Although the ROE measures the return to shareholders, it does not reflect the profitability of the company as a whole, as is the case for the ROA. The difference between ROE and ROA lies in the company's use of leverage, or debt financing. The ROE could be improved if the company depended more on external financing instead of equity. However, as capital structure theory suggests, if the company had more leverage, it would increase financial risk and interest expenses.

7.3.1.5 Operating return on assets (OROA)

OROA is employed by analysts, investors, and other interested parties to assess how efficiently the management is utilising all the assets in a company to generate an operational surplus or profit. The assets have been purchased by the total capital invested in the company. The ratio measures the relationships between the profit before depreciation, interest and tax and the total assets. The ratio is calculated as:

*OROA = (Profit before depreciation interest and tax / total assets) * 100*

A high OROA means that the management is using all of its assets efficiently. This use of the PBDIT figure for calculating OROA is significant. It shows how well the management is utilising its existing assets in generating that amount of profit regardless of the type of finance and taxation system. It is particularly relevant when the company is operating in a range of countries.

7.3.1.6 Operating return on sales (OROS)

Barber and Lyon (1996) and Mikkelson *et al.* (1997) suggest that for new issue firms, profitability should be measured relative to net sales, since issuing firms show large increases in book assets with no commensurate increase in operating income immediately after the issue. It is computed as:

$$OROS = (PBDIT / sales) * 100$$

7.3.1.7 Operating return on equity (OROE)

In the present study, use of the OROE is unsuitable. Because of the new issue, IPO companies witness an increase in their equity. The ratio is calculated as:

$$OROE = (PBDIT / equity) * 100$$

7.3.1.8 Interpretation of the profitability ratios

Table 7-2 shows that the highest gross profit margin recorded was in 1983, when GPM reached 23.22%. This huge increase in GPM was caused by growth in sales, which jumped from SR 311,671,000 in 1982 to SR 489,357,000 in 1983. Then GPM started to drop, to touch 9.30% in 1989, and then increased again to become 13.11% in 1992. It is obvious that the GPM was much higher in the years before the IPO than in the years after. In addition, from 1983 to 1987 the mean and the median of the GPM were 17.86% and 17.95% respectively. On the other hand, from 1988 to 1992, the mean and median of the GPM were 10.67% and 9.80% respectively.

The net profit margin of the company fluctuated in the period from 1983 to 1992. NPM reached 15.37% in 1983, the highest ever, but it dropped immediately in 1984 to record 2.41%. This huge decrease was because of the reduction in sales in 1984. The cost of sales decreased but not as much as the sales did (sales decrease by 15.7% from the 1983 level whereas the cost of sales decreased by only 9.9%). NPM improved a little in 1985, but came down again in 1986 and 1987. NPM in the years after the IPO was relatively stable compared to the years before the IPO, with no higher percentage than 5.37%, recorded in 1992. Moreover, the mean and median for the years before the IPO were 5.27% and 2.41%, and after the IPO were 3.16% and 4.06%.

Regarding the return on assets of the company, it has as the same pattern as the NPM. The most profitable year was 1983 with 14.83%, and then the performance of the firm increasingly deteriorated, reaching, for example, 0.27% in 1990. In addition, the mean for the pre-IPO period was 4.55%, much better than the mean for the post-IPO period of 2.57%. However, the median of the ROA contradicts the mean. The median for the years after the IPO was 3.33%, significantly higher than the median for the years before the IPO, 1.68%. The return on equity goes in the same direction as the ROA. However, it should be borne in mind that IPOs usually witness an increase in their equity and assets. It would be better, therefore, to focus more on sales to measure the profitability of such firms.

The operating return on assets, the operating return on equity, and the operating return on sales show that the operating performance of the company declined after the IPO. For

example, in pre-IPO years, the mean and median of the operating return on sales were 9.41% and 8.41%, while after the IPO they were 6.06% and 5.18%.

The above discussion supports the view that the company exhibited a decline in post-issue profitability performance. Over a ten-year period, extending from five years prior to the IPO until five years after the offering, the performance of the company declined relative to its pre-IPO level, based on several performance measures. However, this result would be more reliable if it was compared to a legitimate benchmark, like the performance of the all industry. Unfortunately, in the case of Saudi Arabia, it is impossible since there is no database provides such needed data.

7.3.2 Growth measures

It was shown in the literature review that most IPOs justify the move to go public by saying that the new money raised will be used for expansion. Growth in sales and capital expenditure were used to find if the company actually grew after making the offer.

7.3.2.1 Growth in sales

Growth in sales can be calculated as:

$$Growth\ in\ sales = [(sales\ in\ year\ 1 - sales\ in\ year\ 0) / sales\ in\ Year\ 0] * 100$$

If the real reason for going public is expansion, the growth in sales should increase continuously. However, if the growth in sales decreases over time, it is an indication that the IPO used the money raised for other purposes.

7.3.2.2 Capital expenditure

Any money spent to acquire or upgrade physical assets such as buildings and machinery, called capital spending or capital expense. Pizzey (1994, p.72) defined capital expenditure as:

> *"Any expenditure for acquiring, expending or improving assets of a permanent nature which are to be used to carry on the business or to increase the earning capacity of the business is termed capital expenditure".*

Capital expenditure can be computed by observing the "payments for purchase of property, plant, and equipment" item, which is shown usually in the cash flow statement. If the company buys more property, plant, or equipment, it means the company is expanding its business. Therefore, if the reason for going public is growth, capital expenditure should increase.

7.3.2.3 Interpretation of the growth ratios

Table 7-2 shows that the sales of the company were growing from 1983 to 1987, except for 1984. On the other hand, the growth in sales started to decrease significantly after two years of going public. The highest sales growth, 57.0% in 1983, and the lowest, -15.7% in 1984, were recorded in the pre-IPO period. The company was able to increase its sales in the first two years after the IPO, however sales then decreased. Moreover, the mean and the median were 15.67% and 7.16% for the years before the IPO and 7.21% and 0.13% for the years after the IPO. From the mean, median, and the sales growth of each

year, it can be seen that the sales growth of the company significantly declined relative to its pre-IPO level.

Regarding growth in capital expenditure, pre-IPO period, the company had relatively high CE for the years of 1983, 1984, and 1985, and then CE dropped significantly in the years 1986, and 1987. CE improved considerably in the first year of going public, jumping from SR 13,238,000 in 1987 to SR 78,938,000 in 1988. However, after just one year of the IPO, CE started to decline to reach SR 30,047,000, SR 10,706,000, SR 13,954,000, and SR 20,630,000 for 1989, 1990, 1991, and 1992 respectively. The mean and median of CE were 44,181,000 and 55,433,000 for the pre-IPO period and 30,855,000 and 20,630,000 for the post-IPO period.

Obviously, according to the growth in sales and capital expenditure, the grew less after the IPO. The mean and median of both sales growth and capital expenditure were significantly higher for the pre-IPO period than the mean and median for the post-IPO period. These findings are consistent with other studies' findings such as Rydqvist and Högholm (1995), and Pagano *et al.* (1998). The expected reasons for this decline are discussed later in this Chapter (Section 7.5 - interviews with the company's officials).

7.3.3 Short-term liquidity measures

The short-term liquidity ratios measure the financial position of the firm and evaluate its ability to pay its bills over the short run without undue stress. These ratios also focus on maturing current liabilities.

High liquidity ratios show that the company is in a good position and can meet, without difficulties, its short-term financial obligations and vice versa. However, to the firm, a high current ratio indicates liquidity, but it also may indicate an inefficient use of cash and other short-term assets. In other words, too much investment in current assets may mean that opportunities for better returns are forgone. In this section, there are five short-term liquidity ratios discussed blow:

7.3.3.1 Current ratio

One of the best-known and most widely used ratios is the current ratio. It measures the ability of the firm's current assets to cover current liabilities without having to raise finance. The measure looks at the liquidity of the firm in a general way and gives a rather inadequate picture of the liquidity of the company. It relates the total current assets to the current liability figure, with the clear assumption that all the components of the current assets are convertible into cash receipts without loss in the short to medium term. Therefore, it assumes that cash, accounts receivable, inventory, etc. all have the same status or can be turned into cash very quickly without loss or with little. It is defined as:

Current ratio = current assets / current liabilities

7.3.3.2 Quick ratio

The quick or acid-test ratio is the same as the current ratio but it deducts inventory, which is often the least liquid of current assets. By omitting inventory, the quick ratio is more practical than the current ratio. It is calculated as:

Quick ratio = (current assets – inventory) / current liabilities

7.3.3.3 Cash ratio

This is a very conservative ratio compared to other ratios, since it considers cash as the only item that can cover short-term liabilities. It is computed as:

Cash ratio = cash / current liabilities

7.3.3.4 Operating cash flow ratio

Basically, this ratio measures the ability of the firm's operations to generate the resources needed to repay its short-term liabilities. It is calculated as:

OCF = cash from operations / current liabilities

7.3.3.5 Net working capital to assets ratio

Since net working capital (NWC) is frequently viewed as the amount of short-term liquidity a firm has. A relatively low value might indicate relatively low levels of liquidity. NWC to assets ratio can be measured by:

*NWC to assets = [(current assets – current liabilities) / total assets] * 100*

7.3.3.6 Interest coverage

Interest coverage ratios measure a company's ability to pay all fixed financial obligations, such as interest payments. The earnings-based ratio indicates the dollars of earnings available for each dollar of required interest payment; the cash-flow-based

coverage ratio indicates the dollars of cash generated by operations for each dollar of required interest payment (Palepu *et al.*, 2000). These ratios are computed as:

Interest coverage (earnings basis) = PBIT / interest expenses

Interest coverage (cash flow basis) = (cash flow from operations + interest expenses + taxes paid) / interest expenses

A coverage ratio of one implies that the firm is barely covering its interest expenses through its operating activities. This is a very risky position. The larger the coverage ratio, the greater the cushion the firm has to meet interest obligations (Palepu *et al.*, 2000).

7.3.3.7 The interpretation of liquidity measures

Table 7-2 demonstrates that a company's ability to pay its short-term liabilities was affected negatively by the decision to go public. All liquidity ratios, except the cash ratio, have higher means and medians for the period prior to the IPO. For example, for the current ratio, the company's current assets in 1986 could cover its current liabilities 2.22 times, whereas in 1990, the company's ability to cover its current debts by current assets was 1.14 times only. In addition, the mean and median of the quick ratio, a more conservative ratio than the current ratio, were 1.17 and 1.31 for the period pre-IPO and 0.82 and 0.83 for the post-IPO period. The cash ratio is not consistent with the others because the company used some of the new money to support its cash account. For example, the company started to sell its shares to the public in 1987 and deposited most of the money in its cash account. Despite the company beginning to use the money raised

in 1988 to finance its operations, the cash account was much higher than its pre-IPO level. Other ratios that test the company's liquidity are interest coverage (earnings basis), and interest coverage (cash flow basis). The interest coverage (cash flow basis) shows that the company on average was able to cover its interest payment obligations 3.83 times, but after the IPO this number went down to 1.59. Also, the median of interest coverage (cash flow basis) for the pre-IPO period was higher than that for the post-IPO period.

The reason for this decline in the liquidity ratios comes from the increased dependence on short-term loans to finance the company's activities. For instance, short-term bank loans and overdrafts jumped from SR 65,998,000 in 1983 to SR 271,651,000 in 1992. In general, the percentage change in current debt from 1983 to 1992 was 253%, while the percentage change in current assets from 1983 to 1992 was 92%. The real reason behind the increase dependence on short-term loans to finance the company's activities is not clear. However, as will be shown in table 7-10 that the interest rate in Saudi Arabia decreased dramatically in the period after the IPO. Therefore, the cost of the short term loan could be a reason.

7.3.4 Long term debt ratios

Long-term ratios evaluate the company's long-term ability to meet its obligations, as well as assessing the relationship between equity and debt. The level of debt and equity is fundamental not only for the shareholders, but also for lenders. For lenders, it provides an indication of the level of debt the company has, if new lenders are considering further lending to a particular company, since it shows the prior commitments the company

already has to other parties. For shareholders, it provides an indication of the financial risk to their dividend payments (Hindmarch and Simpson, 1991). The decision to go public has a great effect on the structure of equity and debt because IPOs increase their equity by issuing new shares, or using the money raised to pay off debt.

7.3.4.1 Total debt ratio

This ratio measures how much the company is dependent upon external and internal financing. It shows the proportion of a company's assets which are financed through debt. Companies with high total debt to asset ratios are said to be highly leveraged and could be in danger if creditors start to demand repayment of debt. The total debt ratio is defined as:

*Total debt ratio = (total liabilities / total assets) * 100*

7.3.4.2 Long-term debt to total assets ratio

Usually, financial analysts are more concerned with a company's long-term debt than its short-term debt, since short-term debt will be constantly changing. Also, a company's accounts payable may be more of a reflection of trade practice than debt management policy. For these reasons, the long-term debt ratio is often calculated as (Ross *et al.*, 1993):

*Long-term debt ratio = (long-term debt / total assets) * 100*

7.3.4.3 Long-term debt to equity ratio

This ratio measures the relationship between the total long-term debt and equity. It shows how many times the debt covers the equity and the formula to calculate it is:

Total debt to equity ratio = long-term debt / total equity

7.3.4.4 Interpretation of long-term ratios

Unsurprisingly, the decision to go public has a substantial impact on long-term ratios. For example, Table 7-2 shows that the mean and median of the long-term debt to assets ratio in the pre-IPO period were 33.23% and 31.27%, while the mean and median for the post-IPO period were 21.82% and 20.83%. In addition, Table 7-5 reveals that the percentage change in long-term debt from 1988 to 1992 was -42.46%. Another example is long-term debt to equity ratio, the mean of which was 0.92 prior to the IPO, and declined to 0.59 after the IPO. The median of the long-term debt to equity ratio also declined from 0.86 to 0.55. These figures show that the company used some of the money raised to pay its long-term debt and decreased its dependence on such sources of finance.

However, the IPO had no effect on the total debt ratio. As shown previously, the company relied more on current debt to finance its operations. It is true that the company decreased its dependence on long-term debt, but the increase in current liability pushed the numerator of the total debt ratio up.

7.3.5 Turnover measures

The measures in this section are sometimes called asset utilisation ratios (Ross *et al.*, 1993). These ratios are intended to provide information about the effectiveness of a firm's investment management. There are two primary areas of asset management (Palepu *et al.*, 2000): (1) working capital management and (2) management of assets.

The components of operating working capital that analysts primarily focus on are accounts receivable, inventory, and accounts payable. A certain amount of investment in working capital is necessary for a firm to run its normal operations. By calculating the working capital management ratios, one can verify the firm's credit policies and distribution policies which determine its optimal level of accounts receivable, and the nature of the production process and the need for buffer stocks determine the optimal level of inventory (Palepu *et al.*, 2000). Asset turnover ratios capture the efficiency of assets in generating sales. Therefore, the higher the ratios, the more efficient is the management.

7.3.5.1 Inventory turnover and days' sales in inventory

Inventory turnover is used to determine whether there is too much or too little invested in inventories. Too much inventory may mean that resources are being used unproductively. Too little inventory may mean that sales, and hence profit, are being lost because of "stockout" (Rao, 1995). It also tells us that how many times a company sells off or turns over the entire inventory (how fast a company sells product). As long as the company is not running out of stock and thereby forgoing sales, the higher this ratio, the more

efficiently the company is managing inventory (Ross *et al.*, 1993). Inventory turnover is computed as:

$$\textit{Inventory turnover} = \textit{cost of goods sold / inventory}$$

Inventory period tells of the average number of days that inventory sits before it is sold. The fewer days inventory stays in the company, the more efficient the company management. Inventory period is calculated as:

$$\textit{Inventory period} = 365\ \textit{days / inventory turnover}$$

7.3.5.2 Receivable turnover and day's sales in receivable

Receivable turnover measures the efficiency of a firm's credit policy. It is defined as:

$$\textit{Receivable turnover} = \textit{sales /accounts receivable}^{33}$$

The receivable period provides information about the days needed to collect credit. Fewer days needed to collect credit implies that the company operates either on a cash basis, or its extension of credit and collection of accounts receivable is efficient. The more days required to collect credit implies that the company should re-assess its credit policies in order to ensure the timely collection of imparted credit not earning interest for the firm. It is computed as:

$$\textit{Receivable period} = 365\ \textit{days / receivable turnover}$$

[33] It is implicitly assumed here that all sales are credit sales. Using total credit sales is better, but it is hard to do so.

7.3.5.3 Operating cycle

The operating cycle is the length of time needed to acquire inventory, sell it, and collect the money owed for it. This cycle has two distinct components. The first part is the time it takes to acquire and sell the inventory, which is called inventory period. The second part is the time it takes to collect on the sales, which is called the receivable period (Ross *et al.*, 1993). Therefore, the operating cycle is:

$$Operating\ cycle = inventory\ period + receivable\ period$$

7.3.5.4 Payables turnover and payables period

Payable turnover and payable period are computed as:

$$Payable\ turnover = cost\ of\ goods\ /\ account\ payable$$

$$Payable\ period = 365\ days\ /\ payable\ turnover$$

These ratios are used to evaluate the probability that a credit applicant will pay on time. If the payable period is high, this shows that a portion of the applicant's payables are not being paid on time.

7.3.5.5 Cash cycle

The cash cycle is the number of days that pass until the company collects the cash from a sale, measured from when the company actually pays for inventory. Therefore, the cash cycle is the difference between the operating cycle and the accounts payable period (Ross *et al.*, 1993):

Cash cycle = operating cycle – accounts payable period

7.3.5.6 Total assets turnover

This ratio measures management's ability to employ assets efficiently. A high asset turnover ratio shows that a large number of sales (and ultimately cash flow) are generated for a given level of assets. A low ratio would indicate that management is using assets in non-cash flow generation, probably in value-destroying ventures. While a higher asset turnover may be identified with efficient asset management practices, and hence shareholders value creation, a lower sales to asset ratio reflects asset deployment for unproductive purposes. Therefore, firms with considerable agency conflict will have lower asset turnover ratios relative to those having less agency conflict. It is computed as:

Total assets turnover = sales / total assets

In the literature review, Chapter 5, it was noted that some researchers, such as Ang *et al.* (1999) and Singh and Davidson (2002), use the ratio of annual sales to total assets as a measure of agency costs. Therefore, it is important to calculate this to measure the effect of the decision to go public on agency costs.

7.3.5.7 NWC turnover

This ratio measures how much work the company gets out of its working capital. A higher value is preferable. It is calculated as:

NWC turnover = sales / NWC

7.3.5.8 Fixed asset turnover

This measures the efficiency of the company in generating revenue by using its available fixed assets. Therefore, the higher the ratio, the more efficient is the management. It is defined as:

$$Fixed\ asset\ turnover = sales / fixed\ assets$$

7.3.5.9 Interpretation of the turnover measures

Table 7-2 shows that inventory turnover and periods improved after the IPO. The mean and median for the inventory turnover increased to 3.88 and 3.88 compared to 2.88 and 2.87 for the period prior to the IPO. The company increased its sold off or turned over inventory by a factor of one, which means the management's policy toward inventory became more effective in the post-IPO period. Further evidence of improved management efficiency is that the mean and median for the inventory period decreased from 135.41 and 127.04 to 100.27 and 94.01, which show that the time inventory sits before it is sold was reduced by approximately 35 days.

The receivable turnover and periods were also affected by the IPO. The mean for the post-IPO period shows that the company was able to reduce the days to collect its money from customers to 39 days and the median for the post-IPO period demonstrates also that the company decreased the days needed to collect its money from consumers, to 36 days. Therefore, the management's credit policy used in the period after the IPO is much better than that used in the period prior to the IPO.

As a result of the significant changes in inventory and receivable periods, the operating cycle also made substantial progress. The mean and median of the operating cycle came down from 275.84 and 278.35 to 201.39 and 203.13, indicating that the time needed to acquire inventory, sell it, and collect the proceeds was reduced by 74 days. This evidence supports the view that the company's management was more efficient in dealing with inventory and receivable accounts in the post-IPO period.

In addition, going public had little or no impact on payables turnover or on payables periods. However, the cash cycle was affected positively by the IPO. The company was able to reduce the number of days that pass until the company collects the cash from a sale, measured from when the company actually pays for inventory, to around 61 days, measured by the mean, and to around 59 days, measured by the median.

Despite the company not being able to maintain high sales growth for the post-IPO period, the mean and median for the total assets turnover picked up a little after the IPO, which means the IPO had a small positive impact on agency costs. This finding is consistent with the findings of McConaughy *et al.* (1995), who documented that IPOs had higher sales to assets ratios a few years after going public. Moreover, NWC turnover jumped substantially after the IPO. The mean and median for the pre-IPO period were just 2.92 and 2.87, while for the post-IPO period they were 8.25 and 8.08. This increase indicates that the company management was using the working capital more efficiently in the post-IPO years. However, the fixed asset turnover had no significant change for the post-IPO years compared to the pre-IPO years.

It may be concluded that the company management was more effective after the IPO measured by inventory, account receivable, operating cycle, cash cycle, NWC turnover, and total assets turnover.

7.4 Interviews with the Company's officials

The researcher held interviews with company's officials to discuss the changes in the financial status and find if the IPO had played a role in those changes. Because of the nature of the questions, the CEO and Financial Manager of the firm were selected for interview. They asked the researcher to keep their names and the company's name confidential. A summary of the findings from the interviews is shown in Table 7-9.

Table 7-9 Summary of the Interview Results: Rankings of what respondents said they believed

Study Variables
A- Motivation:
Use the money raised for expansion and growth
Attract well qualified personnel
Increase the shareholder base and replace foreign owners by Saudis
Become less dependent on outsiders to finance the company's activities
B- Barriers:
The procedure was long
C- Advantages:
Liquidate, easily, part of their investments
Attract well qualified personnel
Improve credit rating
Gain more recognition from the public and investors
More competitive
D- Disadvantages:
More pressure from stakeholders on the management
E- Effects:
The IPO has not affected the profitability
Debt level after the IPO decreased
The browning cost after the IPO decreased
The effect of going public on growth is positive
The IPO has not affected the short term liquidity
The effect of going public on the diversification of the business is positive
The ownership structure after the IPO changed
The effect of going public on the competition is positive
F- An increase in the number of Joint Stock companies affects positively the unemployment rate.
G- The decision to go public is associated with companies with stable and strong economical base, Industrial, Banking.
K- The number of IPOs in Saudi can be increased by encouraging medium and small companies, working in the same business, to merge with each other to create a large one then this new company can go public.

7.4.1 Motivations of the IPO

When the CEO was asked about the real motivations for the IPO, he claimed that there were three motivations that persuaded them to adopt this decision. The first motivation was to increase the shareholder base and replace the foreign owners with Saudis. He said that "*we increased the shareholder base because the company had been supported by the Saudi Industrial Development Fund (SIDF) and the conditions of the SIDF agreement*

required us to increase the shareholder base and replace the foreign owners with Saudi by going public". The SIDF made this stipulation because it funded the company with a large interest-free loan. For instance, the loan provided by the SIDF in 1987 was SR 107,244,000. Therefore, SIDF wanted to make sure that Saudis benefited from this loan. The replacement took place when the foreign owners sold their shares at the IPO. Table 7-1 shows that 525,000 existing shares were sold by the founders at the IPO.

The CEO also said that they were eager to increase the number of owners because a larger number would help the company to gain more experience from the new shareholders and attract better-qualified personnel.

Growth by using the money raised from the IPO was the second motivation, and that is what happened when they sold 550,000 new shares to outsiders. The CEO claimed that this new money was indeed used to expand the business, by, for example, increasing production capacity. From this answer and the financial ratio analysis, it can be seen that there is a conflict with regard to the growth of the company after the IPO. The sales growth and capital expenditure ratios show that the company grew less after it went public. However, the CEO said that they were motivated to go public in order to use the money raised for more expansion. In fact, this was what happened in the first two years after they went public. In 1988 and 1989, sales growth increased by 26.9% and 25.3% respectively, but declined dramatically from 1990. In addition, property, plant, and equipment increased in the first year of the IPO by SR 60,000,000 and in the second year by SR 9,000,000. Capital expenditure in the first year of the IPO jumped to SR 78,938,000 in 1988, while in 1987 it was SR 13,238,000.

The reason given by the CEO and financial manger was that this decline was the result of the Second Gulf War, which started in 1990. For example, the financial manager said that sales had decreased because of external factors. He emphasised that local, regional and international circumstances were the reason. However, from 1992 onwards, sales by the company returned to their previous level, he claimed.

As noted previously, government bodies are responsible for 50% of the company's sales. Moreover, as stated previously, the Second Gulf War caused a huge budget deficit. The average budget deficit for the years 1990 and 1991 came to about 17% of GDP, and the government had to decrease expenditure dramatically and spend most of its fund to pay military costs. The consequence of this crisis was economic slowdown, affecting the company's sales , and indeed, also affecting entire sectors.

To give a broader perspective, Table 7-10 shows the annual Saudi GDP growth, interest rates in the Kingdom, and the foreign exchange rate for two countries, Turkey and Ireland.

Table 7-10 demonstrates that annual Saudi GDP growth was negative continually from 1982 to 1987 and then started to improve in 1988. Thus, it seems that the company sales growth was inversely related to the growth of Saudi GDP. When GDP was negative between 1982 and 1987, the company was able to improve its sales growth. When the GDP performed well in 1990, the company recorded negative sales growth. It should be said here that wars, generally speaking, may boost GDP due to extra war-related government spending. Therefore, the Second Gulf War could be responsible for the good performance of GDP in 1990 and 1991.

Table 7-10 Annual Saudi GDP growth, interest rates, and foreign exchange rates

Year	Annual growth of GDP (%)	Interest rate in Saudi (%)	Exchange rate (Saudi Riyal / Turkish Lira)	Exchange rate (Saudi Riyal / Irish Punt)	Exchange rate (Saudi Riyal / US Dollar)
1982	-15.75	N/A	53 TL	0.19 IP	0.23 $
1983	-15.07	N/A	80 TL	0.23 IP	0.23 $
1984	-5.58	10.76	123 TL	0.27 IP	0.23 $
1985	-10.48	9.08	157 TL	0.21 IP	0.23 $
1986	-14.43	8.04	201 TL	0.19 IP	0.27 $
1987	-0.34	7.36	271 TL	0.16 IP	0.27 $
1988	2.99	8.38	483 TL	0.18 IP	0.27 $
1989	8.03	9.14	616 TL	0.17 IP	0.27 $
1990	22.48	8.23	780 TL	0.15 IP	0.27 $
1991	12.47	6.27	1,353 TL	0.15 IP	0.27 $
1992	3.78	4.07	2,281 TL	0.16 IP	0.27 $

Furthermore, Table 7-10 illustrates the foreign exchange rate of the Saudi Riyal against the Turkish Lira the Irish Punt and US Dollar (SR is pegged to the US $ and the exchange rate was changed slightly in 1986). Firstly, the majority of the company's subsidiaries and associated companies are located in Turkey, and most of its exports go to Turkey. Table 7-10 shows that, from 1982 to 1992, the TL deteriorated against the SR. Since an increase in the SR value would harm its exports, the company probably was not able to export more, especially after the IPO period. For example, TL in 1992 depreciated by around 90% from its level in 1991. Secondly, a good portion of the company exports also go to Ireland and the company has some subsidiaries and associated companies in that country. Table 7-10 illustrates that the Saudi Riyal has, to a large extent, been relatively stable against the Irish Punt. However, the IP was lower in the pre-IPO period than the post-IPO period, meaning the company should be able to export more to Ireland in the period after the IPO.

The third motivation was to become less dependent on outsiders for financing new or ongoing projects or other activities of the company. He stated, "*when the company was*

listed on the Saudi Stock Market in 1991, it gave us the ability to finance our activities by selling new shares in the market. For example, in 1992, we raised SR 5,550,000 by selling 30,000 shares". Moreover, the financial manager supported this claim when he said that they had changed their financing strategy, because they can now always finance their major projects from the stock market. He said, "*our dependence on external debt decreased after the IPO. However, that does not mean we cancelled the idea of borrowing from some financial institutions, because we now have more willing financial institutions to finance our activities with cheap interest rates*". The financial manager also claimed that they used some of the money raised to pay some of their debt back. From observing the long term debts in the balance sheet, Table 7-3, the company in fact terminated loans worth SR 73,938,000 in 1990. However, the company increased its long term debts in 1991 by SR 47,377,000 then decreased them again by SR 59,355,000 in 1992. Furthermore, Tables 7-2 and 7-3 show that the company indeed became less leveraged after the IPO. For example, the percentage change in long-term debt from 1988 to 1992 was -42.46% and the long term debt to assets ratio in 1988 was 30.64% while in 1992 it was just 14.95%.

From the above discussion, it could be said that the company looked to expand but the economic overlook changed and they used the cash instead to terminate debt, being overtaken by external events.

7.4.2 Barriers to a Saudi IPO

The researcher asked the CEO if they faced any barriers when they decided to go public. He said, "*I do not think there were major barriers except the procedure took a very long time and there was a list of requirements we had to submit*".

7.4.3 Advantages of the IPO

The CEO claimed that the IPO had created some advantages and also disadvantages. He believes that the most important advantage was hiring more Saudi personnel. He said, "*in fact, Saudis prefer to work in governmental institutions or joint stock companies because these are safer and have clear roles. Therefore, after we moved into becoming a JSC, the number of well-qualified Saudi applicants increased dramatically*". Another advantage was that the company is now able to more easily find financial institutions willing to finance their activities at lower interest rates. In addition, as a founder, he claimed that he had noticed that listing on the stock market gave him more flexibility if he wanted to cash his shares. Whenever I need cash, I can sell my stocks at any time on the stock market, he said. Another clear advantage, he thinks, is that the company has become more recognisable and competitive locally, regionally, and internationally.

7.4.4 Disadvantages of the IPO

Regarding the disadvantages of the IPO, he claimed that he could not see any major disadvantages. However, being listed on the stock market and with the company share price volatile for internal and external factors, the major shareholders put the

management under huge pressure to perform well. Sometimes this great pressure has a negative effect, he said.

7.4.5 Effects of the IPO on the company

The financial manager was asked to explain why most of the profitability ratios went down after the IPO. He believes that the decision to go public had nothing to do with the decrease in the profitability. He was aware that there was a small percentage decrease in all the profitability ratios, however, he claimed that this decrease came about because of the local and regional situation. He added that with Iraq invading Kuwait in 1990 and the Second Gulf War starting in early 1991 and ending in the middle of 1991, this war caused an economic slow down, something of a depression, affecting all businesses in the region. Therefore, he thought the reason for a small decrease in profitability came from external factors.

When CEO was asked if they had diversified their business after the IPO, he said yes. They diversified the business because they thought diversification would help them to enter new markets and attract more customers, and this is what happened. They used the money raised from selling the new shares to build new production lines, which produce new kinds of products, he claimed. For example, Table 7-5 shows that investment in subsidiaries and associates increased by 128.58% from 1988 to 1992 and 716.7% from 1983 to 1992. Moreover, the balance sheet had another item called "other investment" which appeared after the IPO. "Other investment" in 1988 was SR 21,110,000 and SR 38,375,000 in 1992.

The financial manager was asked to explain whether the position of being a Joint Stock Company helped them to have a stronger negotiating position with the finance suppliers for paying lower interest rates. He said that, in general, interest rates were affected by many internal and external factors. The position of being a JSC helps access to lower interest rates. The financial suppliers trust JSCs more because these companies disclose all the information needed. They are also monitored by governmental bodies, such as the Ministry of Commerce. In addition, after going public, the company had fewer loans. If they had remained as a private company, they would be paying more than what they paid after becoming a JSC, he said. In fact being a JSC could give the company access to lower interest rates, but, it should be known that the general interest rate level in the country decreased in the late 1980s. Table 7-10 shows that the interest rate level in the Kingdom diminished from 10.76% in 1984 to 4.07% in 1992.

The CEO was also asked by the researcher to explain if the ownership structure had changed after the IPO. If so, was it intentional or not, and what were the consequences? His answer was 'yes'. The ownership structure changed after the IPO. Nevertheless, some of the founders were still holding large numbers of shares. As he said at the beginning, one of the motivations for going public was to increase the shareholder base. Therefore, the change was organised from the beginning, he claimed. In addition, he thought the major consequence was that the management of the company had changed with new people with deeper experience.

The financial manager was asked to explain if the IPO had an effect on the liquidity of the company, because the liquidity ratios also show that the ability of the company to

meet its short-term obligation was better in the period before the IPO. He claimed that, after they went public, they had new management. Every manager had his particular vision and ideas. He believed the change in the liquidity ratios happened because of decisions taken by management as management decisions, not from the decision to go public.

The CEO thought their position as a Joint Stock Company had helped them to become more competitive. He claimed that they had become a bigger company with a large production capacity. He stated, "*as you know, if the company is very large, it can reduce the operational costs more easily than a small company. We actually reduced our operational costs and were able to give our customers better offers than our competitors. In addition, we won the Best Factory Prize and ISO (International Standards Organisation) Certificate*". From the company turnover ratios, discussed earlier in this Chapter, the management was more efficient after the IPO. For instance, the mean and median for the total assets turnover increased a little after the IPO. One interpretation of this is that the IPO had a positive impact on agency costs.

7.4.6 Effects of an increased number of Saudi IPOs on the economy

The CEO believed that an increase in the number of Joint Stock companies would have a positive impact on the Saudi economy. He said: "*JSCs are created by large number of investors and become large companies with a large capital base. These companies can work in businesses which are sometimes difficult for individual investors to work in, such as communications or energy. Therefore, every country needs these kinds of companies to*

help the government to provide some necessary services. In addition, these kinds of companies can help also the government to provide jobs for the people".

7.4.7 Characteristics of Saudi IPOs

The researcher asked the CEO if he thought the decision to go public was associated with particular kinds of companies. His answer was 'yes'. He stated, "*I think any company which has a stable and strong economic base, can go public. In particular, companies working in the industrial and banking sectors are capable of going public because they are trusted by the people and the legislators*".

7.4.8 Suggestions to increase the rate of Saudi IPOs

Finally, the CEO was asked to give some suggestions which would improve the rate of going public. He believes that most companies working in the Kingdom are medium-and small-sized. Therefore, the rate of going public would be improved by encouraging companies working in the same business to merge with each other to create a larger company. Then this larger company could go public more easily because it would have the necessary requirements, such as capital size. Interesting, IPOs have always been used to facilitate future mergers or acquisitions, however, the CEO here thinks a merger is a step towards making an IPO rather than the other way around.

7.5 Summary

This chapter was in three parts. The first part gave information about a company that had made an IPO in Saudi Arabia. The background to the company and the IPO process were

discussed. It has been shown that the Saudi government is the main customer of the company. Additionally, this section clarified that the company went public in the end of 1987 when floated 1,075,000 shares to the public. This section also presented some information about the competition level in the company's industry. The company had some competition from other local, regional, and international companies.

As has been discussed in this chapter and the Chapter six (the methodology chapter) the researcher in this study used the financial analysis technique to capture the financial and managerial changes before and after the IPO. Chapter six also showed that one of these disadvantages of this technique is that the financial ratio method does not take into consideration accounting policy changes. To eliminate this disadvantage, the first part presented the significant accounting policies, adopted by the company under the investigation, pre and post the IPO. The review showed that the company has kept the same policies during the years under the examination, making the financial ratio technique more reliable and also rejecting the idea of earnings management, which is often associated with IPOs. Finally, since the economic condition could affect the company's performance, the first section discussed the general economic situation before, at the time of, and after the IPO. The Saudi economy and government budget in the early 1990s performed poorly because of some factors, especially the Second Gulf War.

The second part investigated the financial performance of the company. A comparison between the financial performance before and after the IPO was made by using financial ratios. Profitability, growth, liquidity, and long-term debt ratios all mostly decreased after the IPO. Most of these ratios, such as the profitability and growth, preformed well in the

first two years after the IPO, however, they started to decline dramatically in the third year of the IPO. Therefore, this decrease was seemed to be associated with the general economic slowdown caused by the Second Gulf War in 1990.

Because of the lack of data about the related firms in the same industry and because of the absence of a reliable benchmark that the researcher can compare his results with, more investigations were made by interviewing the company's officials. The third part of this chapter revealed some important information obtained from holding these interviews. Because of the nature of the questions, interviews were held with the CEO and the financial manager of the company. They claimed that they went public for various reasons, such as using the money raised for expansion and growth, increase the shareholder base, and attracting well-qualified personnel. Moreover, they insisted that they did not face any barriers when they went public, except that the procedure was somewhat long. They also thought that the status of being a JSC gives the owners certain advantages, such as liquidating part of their investments very easily, and improving the credit rating. However, this position also created some disadvantages, such as more pressure from stakeholders on the management. They revealed that the ownership structure changed after the IPO, and the growth of the company increased after the IPO. Also, they paid lower interest rates, became more competitive, and diversified their business after the IPO. Furthermore, they think that an increase in the number of joint stock companies would affect positively the unemployment rate. The decision to go public is associated with companies with a stable and strong economic base, particularly in the industrial and banking sectors. The number of IPOs in Saudi Arabia can be increased by encouraging medium and small-sized companies working in the same

business to merge with each other to create larger entities. These new companies can then go public.

It can be concluded that the results of the financial ratio analysis and interviews were consistent in most cases. For example, one motivation for going public, mentioned by interviewees, was to increase the shareholder base and that what has happened when the original shareholders sold a good portion of their stocks at the time of the IPO (525,000 shares out of 1,075,000 share sold at the IPO). Another motivation for the IPO mentioned was to use the money raised for more growth and expansion and also that what has happened in the first two years after the IPO, as all the growth ratios increased. However, as claimed by the interviewees, external events, the Second Gulf War, have forced the company to slow down its growth and started to repay its debts instead, since the environment for growth was not promising.

Finally, the interviewees blamed entirely the external events for the negative changes in the company's financial performance and they rolled out the effect of the internal factors, such as the going public decision. Nonetheless, if the top management had diversified its customer base, like increasing its presence in other countries' markets, and had not depended strongly on the government purchases, it would had eliminated the impact of the Saudi economic crisis in 1990.

Chapter Eight: The analysis and results of questionnaire and interview data

8.1 Introduction

Chapter Six, the methodology, showed that this study employed two data collection techniques, a questionnaire and interviews. These are standard techniques and there is nothing in this research that prevents them being used in a standard way. In this chapter, the results of the empirical investigation, the questionnaire and other interviews, are presented, analysed and interpreted. The chapter is divided into two parts. The first part deals with quantitative issues. The researcher examines the response rate, discusses the statistical procedures employed to analyse the data obtained from the questionnaire, summarises the descriptive statistics of the respondents and their firms, examines non-response bias, and analyses the main questions in the questionnaire. The second part of the chapter deals with the qualitative methodology, the interviews. Finally, the discussions and justifications of the results obtained from the questionnaire and the interviews are discussed in the next chapter.

8.2 Statistical analysis

Both descriptive and inferential tests are used in this study. The following subsections reviews these tests fully.

8.2.1 Descriptive statistics

The questionnaire used in this study utilises a five point scale (a Likert Scale) for most questions, where one represents the lowest point (strongly disagree) and five represents the highest point (strongly agree). Therefore, the researcher was able to calculate the means, standard deviations, coefficients of variation, and frequencies, helping to rank average responses to a problem or an issue in order. For example, a response with a mean score of 3.6 is ranked higher than a response with a mean score of 2.7. The rank order is particularly important for this study in that it indicates respondents' opinions in terms of their perception of the importance of a specific issue.

To generate an indicator to measure the spread of individual responses within a particular distribution (that is, responses to a specific question) the standard deviation of the respondents' answers was computed to measure how much the outcomes varied above or below the expected outcome of the mean. In addition, to test the differences between the variables, the coefficient of variation was calculated. The percentages of those who strongly agreed, agreed, neither agreed nor disagreed, disagreed, or strongly disagreed were computed.

8.2.2 Inferential statistics

Inferential statistics help the researchers to make decisions or inferences by interpreting data patterns and to determine whether an expected pattern designated by the theory and hypotheses is actually found in the observations (Nachmias and Nachmias, 2002). Within

inferential statistics, there are two types of significance tests, parametric and non-parametric.

8.2.2.1 Parametric tests

A parametric test is based on several assumptions about the parameters of the population from which the sample was drawn. The most important assumptions are:

- The sample was drawn from a normally distributed population
- The sample was drawn at random
- The variables were measured on at least an interval or ordinal scale

If an ordinal scale, like a Likert scale, is used, some statisticians suggest the use of a nonparametric test, such as the Wilcoxon Mann-Whitney test and Kruskal Wallis test. However, others suggest that researchers employ parametric tests, such as the t-test, with an ordinal scale because the tests apply to numbers and not to what those numbers represent. Moreover, if the sample size is large, then using parametric tests is acceptable (Bryman and Cramer, 1996). Therefore, in this study, the t-test was used to find if there were significant differences between the answers for two independent variables, and an analysis of variances (ANOVA) was used to find if there were significant differences between the answers for more than two independent variables.

8.2.2.2 Non-parametric tests

Non-parametric tests are considered distribution-free methods because they do not rely on any underlying mathematical distribution, and they are helpful for problems that

include one or more variables measured on a nominal or categorical scale (Sekaran, 1992). The chi-square test (a non-parametric test) was used in this study for some questions, to show whether or not there was a significant mean difference between independent variables. It was performed firstly to test the representativeness of the response from the participating sample by comparing the frequencies of the respondents with those who did not respond, and secondly to test Question 13 of the questionnaire which asked participants if they believed that, after the transition, the profitability of IPOs (A) increases (B) decrease (C) do not change (D) do not know.

Finally, all the above statistics were calculated using SPSS 11.0 for Windows, a release that is considered a powerful statistical software package and also provides the value of the statistic and the critical value P. In general, the 5% level is widely accepted as a reasonable level of significance in social science research, therefore, this significance level was employed in this study.

8.3 Results from the questionnaire (quantitative methodology)

8.3.1 The response rate

Of the 500 firms, 151 responded. Three companies mailed letters excusing themselves from answering the questionnaire. In addition, three questionnaires were excluded by the researcher because there were too many questions left unanswered. Therefore, there were 145 usable questionnaires (a 29% response rate). Before follow up letters, telephone calls, and visits by the researcher, 89 questionnaires were received, and 56 responses were received after the follow up.

8.3.2 Testing the representativeness of responses

All received questionnaires were checked and inspected for representativeness of the selected sample of 500 firms. The frequencies and percentages presented in Table 8-1 give a clear indication that the sample used in this study suffers from neither sector bias nor legal status bias[34]. To ensure the sample does not exhibit significant bias, a chi-square test (X^2) of the distribution of the original sample (500 firms) and the set of usable responses (145 firms) was employed to test the null hypothesis that there are no statistically significant differences.

Table 8-1 Comparison between the original sample and the sample used in this study and chi-square test results of differences between them by sector and legal status of firm

Category		Original Sample		Participated		Test Results		
		No.	%	No.	%	X^2	CV	P-Value
Sector	Agriculture	28	5.6%	7	4.8%	1.140	12.59	0.980
	Contracting	36	7.2%	9	6.2%			
	Trading	98	19.6%	27	18.6%			
	Financing	18	3.6%	6	4.1%			
	Services	72	14.4%	18	12.4%			
	Manufacturing	87	17.4%	27	18.6%			
	Diversified	161	32.2%	51	35.2%			
	Total	**500**	**100%**	**145**	**100%**			
Legal Status	Sole Proprietorship	146	29.2%	40	27.6%	1.148	9.48	0.887
	Partnership	25	5.0%	10	6.9%			
	Liability Partnership	21	4.2%	7	4.8%			
	Limited Liability	231	46.2%	64	44.1%			
	Joint Stock	77	15.4%	24	16.6%			
	Total	**500**	**100%**	**145**	**100%**			

X^2 is chi-square result. CV is the critical value of X^2 (X^2 significant level, degree of freedom)

The chi-square results, also given in Table 8-1, show that there are no significant differences between the original sample and the usable sample for both sector and legal status. The p-values for the sector and legal status are greater than 0.05 meaning that the hull hypothesis cannot be rejected. Moreover, the p values are very high giving a

[34] Respondents were not concentrated in specific sectors or in specific kind of companies.

conclusion that the usable responses are representative of the original sample and the results can be generalised.

8.3.3 Testing for non-response bias

A drawback of mail surveys is that their typically low response rates provide a greater likelihood of non-response bias. Estimates and confidence statements can be misleading when based only upon information from sampled individuals who gave a response. Non-response bias can occur if the preferences of responding individuals differ from those of non-respondents. Non-response bias can also occur when late-responding individuals perhaps do not take the study seriously and, therefore, give unreliable answers. Thus, it is recommended that researchers carry out a non-response bias test.

For this study, the best way to test for non-response bias was to classify respondents into two groups, the early and late responses, and to compare these two groups to find if there were significant differences between their answers. The questionnaires were mailed from the United Kingdom on 18-2-2003 and the follow-up letters were sent from Saudi Arabia on 31-03-2003. Therefore, questionnaires received up to five days after mailing the follow-up letters were considered to be early responses, and questionnaires received more than five days after mailing the follow-up letters were considered to be late responses. Table 8-2 shows that the total number of questionnaires received before the fifth day of mailing the follow-up letters was 89, and the total number of questionnaires received after the fifth day of mailing the follow-up letters was 56.

Table 8-2 Early and late responses and the methods used to return the questionnaires

Method of returning the questionnaire	Early Response		Late Response		Total	
	No.	%	No.	%	No.	%
By fax	15	16.9	4	7.1	19	13.1
By mail using provided envelopes	67	75.3	38	67.9	105	72.4
By mail using their own envelopes	7	7.9	14	25.0	21	14.5
Total questionnaires returned	**89**	**100.0**	**56**	**100.0**	**145**	**100.0**

The two independent samples t-test was used to compare the two groups. The test is a test of differences in means between the early response and the late response groups. The null hypothesis is that there were no statistically significant differences between the early and late responses. Three major questions were tested to see if there were statistically significant differences between the two groups. Tables 8-3, 8-4, and 8-5 show the t-test and p-values[35]. The p-values for all the variables show that the null hypothesis of no difference in means is not rejected. Indeed, no where in any of the tables is there any evidence of any difference in means supporting that there is no non-response bias.

[35] The t- test is fairly robust. It can tolerate some departure from normality without losing much efficiency, but large departures can be devastating.

Table 8-3 Two independent samples t-test result for non-response bias (motivations for going public)

Motivations	E.R.M	L.R.M	T-Test	P-Value
Original owners take their companies public to liquidate part of their investment	3.933	3.661	1.671	0.097
Original owners take their companies public to diversify part of their investment	4.034	4.214	-1.363	0.175
Original owners take their companies public to solve the problem of lack of family succession and control	3.909	4.091	-1.040	0.300
Original owners take their companies public to overcome the conflicts accruing between the owners about the leadership	3.345	3.491	-0.648	0.518
Original owners take their companies public when they know that the profitability is about to decline permanently (time their offerings with high performance to sell their shares at higher prices)	2.719	3.107	-1.947	0.054
Companies go public to use the money raised for more expansion and growth	4.202	4.339	-1.274	0.205
Companies go public to use the money raised to pay their debt	3.146	3.107	0.215	0.830
Companies go public to improve credit rating	3.091	2.855	1.267	0.207
Companies go public to evaluate and monitor management and employees	2.865	2.804	0.328	0.743
Companies go public to motivate and create incentive to the management and employees	3.023	2.875	0.799	0.426
Companies go public to acquire and merge with other companies	3.607	3.696	-0.533	0.595
Companies go public to enhance the company image and publicity	3.596	3.679	-0.444	0.657
Companies go public to be recognised by investors	3.371	3.625	-1.293	0.198
Companies go public to establish a value for the firm	3.461	3.357	0.493	0.623
Companies go public to attract well qualified personal	3.489	3.482	0.033	0.974
Companies go public to make firm's products better known	3.391	3.536	-0.751	0.454
Companies go public to avoid bankruptcy	2.932	2.964	-0.150	0.881
Companies go public to be more competitive	4.023	4.250	-1.915	0.058
Companies go public to enhance employee status	2.614	2.782	-0.901	0.369
Companies go public when they are overvalued by outside investors	3.573	3.375	1.062	0.290
Companies go public when there is sharp stock price increase	3.517	3.696	-1.008	0.315
Companies go public because there are few resources of finance	3.205	3.145	0.326	0.745
Companies go public because the competition in their market is severe	3.360	3.661	-1.569	0.119
Firms go public because the government eases the procedures for going public	2.898	2.589	1.671	0.097
Firms go public because the government grants more subsidies to joint stock companies	3.090	3.411	-1.603	0.111
Firms go public because the government reduced the income tax rate	2.839	2.855	-0.080	0.936
Firms go public because the government allowed GCC citizens to own stocks in the Saudi Stock Market (SSM)	3.202	3.071	0.687	0.493
Firms go public because the government allowed foreign investors to participate in the SSM through special funds established by commercial banks	3.068	3.036	0.165	0.869

E.R.M is early response mean, and L.R.M is late response mean.

Table 8-4 Two independent samples t-test result for non-response bias (barriers to going public)

Barriers	E.R.M	L.R.M	T-Test	P-Value
Owners avoid going public because of the possible negative impacts on their relationships with managers and employees	2.854	2.839	0.071	0.943
Owners avoid going public because of the possible loss of control	3.775	3.893	-0.646	0.519
Fear of more restrictions on private transactions	3.629	3.696	-0.372	0.711
Lack of experience about the legal and financial points related to the IPO	3.303	3.411	-0.551	0.582
Lack of well experienced personnel who can manage companies after transition	2.640	2.768	-0.696	0.487
Fear of the increase in agency costs	2.899	2.804	0.527	0.599
External investor scrutiny	3.239	3.000	1.143	0.255
Dividend pressure	3.169	3.089	0.415	0.679
Unwelcome attention regarding a possible takeover	3.648	3.418	1.240	0.217
Fear that the offer price might be less than market price in the first day	3.180	3.089	0.481	0.631
The difficulty of determining the real value of the firm	3.295	3.214	0.402	0.688
Liquidity in the Saudi market is limited	3.057	3.268	-1.021	0.309
There are few underwriters in the country	2.854	2.804	0.259	0.796
There is no complete financial system	3.539	3.339	0.966	0.336
Stock market is not open completely for international investors	3.602	3.582	0.106	0.915
The failure of many joint stock companies listed in the SSM to generate profits	3.955	4.089	-0.800	0.425
Expenses and fees associated with the procedures of going public are high	3.034	2.839	1.163	0.247
Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	3.449	3.321	0.651	0.516
Restricted regulations from the Department of Zakat and Income Tax	3.202	2.911	1.601	0.112
More disclosure requirements	3.326	3.357	-0.170	0.865
The ambiguity in regulations that cover fundamental IPO issues	3.292	3.161	0.699	0.486
Income tax rate is high	2.663	2.518	0.879	0.381

E.R.M is early response mean, and L.R.M is late response mean.

Table 8-5 Two independent samples t-test result for non-response bias (suggestions to improve the rate of going public)

Suggestions	E.R.M	L.R.M	T-Test	P-Value
The decision makers in private firms should increase companies' size to be big enough	3.667	3.768	-0.578	0.564
The decision makers in private firms should reshape companies' organisational structure	4.247	4.268	-0.179	0.858
The decision makers in private firms should separate management from ownership and hire well-experienced personnel to lead the companies	4.303	4.196	0.729	0.467
The decision makers in private firms should disclose more information about their companies' activities and financial status to the public	4.045	3.982	0.478	0.633
The decision makers in private firms should enrol in some training programmes which may increase their knowledge about the IPO issues	3.989	3.796	1.340	0.182
The Saudi government should create a complete financial system	4.382	4.375	0.057	0.954
The Saudi government should allow non-Saudi investors to participate freely in the SSM	4.225	4.071	1.010	0.314
The Saudi government should allow banks to invest in the SSM	3.944	3.750	1.027	0.306
The Saudi government should ease the regulations for firms and persons willing to be underwriters	4.169	3.911	1.816	0.071
The Saudi government should allow foreign companies to be listed in the SSM	3.586	3.364	1.104	0.272
The Saudi government should ease the regulations for firms willing to go public	4.281	4.214	0.586	0.558
The Saudi government should grant IPOs more subsidies	3.573	3.446	0.610	0.543
The Saudi government should prepare clear guidelines that explain the procedures for going public	4.348	4.357	-0.077	0.939

. E.R.M is early response mean, and L.R.M is late response mean.

8.3.4 The characteristics of the respondents and their firms (part one of the questionnaire)

The results from Part One of the questionnaire are summarised in Table 8-6 and complete frequencies and percentage of participants and their firms are presented. The age of 42.8% of the participants is in the range 41 to 50 years old, and 84.8% are Saudis.

A majority of respondents (65.5%) are the presidents and a further 17.9% are the vice president of their firms. This means that the great majority of respondents are from top management. This is important for this study, as the decision to become a public company is a strategic one, made by top management. Most participants are well-

educated in business matters, since 95% hold undergraduate and postgraduate degrees, and 70.1% hold a degree in business studies.

Table 8-6 also shows that the highest number of respondents came from firms working in more than one sector (35.2%), then both the trading and the manufacturing sectors (18.6%), followed by the service sector (12.4%).

In addition, 44.1% are limited liability companies, 27.6% are sole proprietorships, 16.6% are joint stock, 6.9% are partnerships, and 4.8% are limited liability partnerships. As can be seen, most are private companies, with the potential to go public (83.4%), while the rest are joint stock companies, which have been included because they may made an IPO, so having greater knowledge of the issue.

Furthermore, Table 8-6 shows that 35.2% of the firms are from 21 to 30 years old and 22.1% are from 31 to 40 years old. This is not surprising, since it is correlated with the sharp increase in oil prices in the 1970s, which had a strong positive effect on the Saudi economy. Lastly, 43.4% of participated firms employ less that 500 personnel, 42.1% have from 500 to 1000 employees, and 14.5% conduct their business with more that 1000 personnel.

What this suggests is that the questionnaire responses are from mature, authoritative individuals, who are well experienced in management, and will indeed those who are potential IPO companies. This leads significant credence to the results.

Table 8-6 Summary statistics of the participants' background and the characteristics of their firms

Category		No.	%
Participants' age	Less than 30 years	10	6.9%
	From 30 to 40 years	43	29.7%
	From 41 to 50 years	62	42.8%
	From 51 to 60 years	20	13.8%
	More than 60 years	10	6.9%
	Total	**145**	**100%**
Participants' nationality	Saudi	123	84.8%
	Other nationalities	22	15.2%
	Total	**145**	**100%**
Participants' position	President (Manager)	95	65.5%
	Vice president	26	17.9%
	Financial manager	12	8.3%
	Other positions	12	8.3%
	Total	**145**	**100%**
Participants' level of education	Less than bachelor degree	7	4.8%
	Bachelor degree	86	59.3%
	Postgraduate degree	52	35.9%
	Total	**145**	**100%**
Participants' field of study	Business studies	101	70.1%
	Other studies	43	29.9%
	Total	**144**	**100%**
Firms' sector	Agriculture	7	4.8%
	Contracting	9	6.2%
	Trading	27	18.6%
	Financing	6	4.1%
	Services	18	12.4%
	Manufacturing	27	18.6%
	Diversified	51	35.2%
	Total	**145**	**100%**
Firms' legal status	Sole proprietorship	40	27.6%
	Partnership	10	6.9%
	Liability partnership	7	4.8%
	Limited liability	64	44.1%
	Joint stock	24	16.6%
	Total	**145**	**100%**
Firms' age	Less than 10 years	6	4.1%
	From 10 to 20 years	28	19.3%
	From 21 to 30 years	51	35.2%
	From 31 to 40 years	32	22.1%
	More than 40 years	28	19.3%
	Total	**145**	**100%**
Number of employees	Less than 500 employees	63	43.4%
	From 500 to 1000 employees	61	42.1%
	More than 1000 employees	21	14.5%
	Total	**145**	**100%**

8.3.5 The motivations for going public in Saudi Arabia

In Part Two, Question Nine of the questionnaire asked participants for the possible motivation which would encourage decision makers in private firms to take their companies public. Twenty-eight possible motivations were listed, and the participants expressed their opinions by using the 5-point Likert scale (from 1= strongly disagree to 5= strongly agree).

Table 8-7 illustrates the rank, means, standard deviations, and coefficient of variations, of all possible motivations for going public in Saudi Arabia. The motivation "companies go public to use the money raised for more expansions and growth" has the highest level of agreement between respondents (4.255 mean, 0.632 SD. and 0.149 CV.). "Companies go public to be more competitive" is ranked as the second motivation with 4.111 mean, 0.701 SD., and 0.171 CV. The third most accepted motivation for going public is "original owners take their companies public to diversify part of their investment" with 4.103 mean, 0.779 SD., and 0.190 CV. The fourth motivation is "original owners take their companies public to solve the problem of lack of family succession and control" with 3.979 mean, 1.017 SD., and 0.256 CV. "Original owners take their companies public to liquidate part of their investment" is ranked fifth (3.828 mean, 0.960 SD., and 0.251 CV.). The respondents ranked "companies go public to acquire and merge with other companies" sixth (3.641 mean, 0.984 SD., and 0.270 CV.), and "companies go public to enhance the company image and publicity" as seventh (3.628 mean, 1.093 SD., and 0.301 CV.).

However, Table 8-7 also shows that some motivations are not supported by the participants. For example, "companies go public to enhance employee status" has only a mean score of 2.678.

While the ranking in Table 8-7 is based on means, the final column of the Table shows the coefficients of variation – a measure of relative variability of the motivations. What this columns shows is that the ranking would be virtually identical if the CV was used. This makes the results ever more strong. Not only the respondents order the motivations at the average, there is little also disagreement amongst them.

Table 8-7 Ranks, means, standard deviations (SD), and coefficients of variation (CV) of the motivations for going public in Saudi Arabia

Motivations	Rank	Mean	SD	CV
Companies go public to use the money raised for more expansion and growth	1	4.255	0.632	0.149
Companies go public to be more competitive	2	4.111	0.701	0.171
Original owners take their companies public to diversify part of their investment	3	4.103	0.779	0.190
Original owners take their companies public to solve the problem of lack of family succession and control	4	3.979	1.017	0.256
Original owners take their companies public to liquidate part of their investment	5	3.828	0.960	0.251
Companies go public to acquire and merge with other companies	6	3.641	0.984	0.270
Companies go public to enhance the company image and publicity	7	3.628	1.093	0.301
Companies go public when there is a sharp stock price increase	8	3.586	1.045	0.291
Companies go public when they are overvalued by outside investors	9	3.497	1.094	0.313
Companies go public to attract well qualified personal	10	3.486	1.147	0.329
Companies go public because the competition in their market is severe	11	3.476	1.131	0.325
Companies go public to be recognised by investors	12	3.469	1.155	0.333
Companies go public to make firm's products better known	13	3.448	1.124	0.326
Companies go public to establish a value for the firm	14	3.421	1.229	0.359
Original owners take their companies public to overcome the conflicts accruing between the owners about the leadership	15	3.401	1.305	0.384
Firms go public because the government grants more subsidies to joint stock companies	16	3.214	1.18	0.367
Companies go public because there are few resources of finance	17	3.182	1.052	0.331
Firms go public because the government has allowed G.C.C citizens to own stocks in the Saudi Stock Market (SSM)	18	3.152	1.114	0.353
Companies go public to use the money raised to pay their debt	19	3.131	1.056	0.337
Firms go public because the government has allowed foreign investors to participate in the SSM through special funds established by commercial banks	20	3.056	1.118	0.366
Companies go public to improve their credit rating	21	3.000	1.088	0.363
Companies go public to motivate and create incentives to the management and employees	22	2.965	1.08	0.364
Companies go public to avoid bankruptcy	23	2.944	1.226	0.416
Original owners take their companies public when they know that the profitability is about to decline permanently (timing their offerings with high performance to sell their shares at a higher price)	24	2.869	1.18	0.411
Firms go public because the government reduced the income tax rate	25	2.845	1.119	0.393
Companies go public to evaluate and monitor management and employees	26	2.841	1.097	0.386
Firms go public because the government eased the procedures for going public	27	2.778	1.087	0.391
Companies go public to enhance their employees status	28	2.678	1.085	0.405

This ranking by relative variability is also confirmed by the percentage rate of responses. Table 8-8 shows the percentages of responses to the motivations of going public in Saudi Arabia. A large majority - 94% of respondents - agree or strongly agree and none strongly disagree with "companies go public to use the money raised for more expansion and growth". Almost as many - 89% of the respondents - agree or strongly agree with "companies go public to be more competitive". Likewise, 87% of respondents agree or strongly agree with "original owners take their companies public to diversify part of their investment", whereas 74% of the participants agree or strongly agree with "original owners take their companies public to solve the problem of lack of family succession and control", and 74% of the participants agree or strongly agree with "original owners take their companies public to diversify part of their investment".

Table 8-8 Percentage of responses regarding the motivations for going public in Saudi Arabia

Motivations	1	2	3	4	5
Companies go public to use the money raised for more expansion and growth	0%	2%	4%	60%	34%
Companies go public to be more competitive	0%	4%	7%	63%	26%
Original owners take their companies public to diversify part of their investment	1%	4%	9%	57%	30%
Original owners take their companies public to solve the problem of lack of family succession and control	1%	12%	13%	39%	36%
Original owners take their companies public to liquidate part of their investment	0%	15%	10%	51%	23%
Companies go public to acquire and merge with other companies	4%	11%	15%	57%	13%
Companies go public to enhance the company image and publicity	1%	21%	10%	49%	19%
Companies go public when there is a sharp stock price increase	1%	22%	10%	45%	21%
Companies go public when they are overvalued by outside investors	3%	17%	15%	48%	17%
Companies go public to attract well qualified personal	6%	15%	19%	46%	15%
Companies go public because the competition in their market is severe	3%	25%	13%	40%	19%
Companies go public to be recognised by investors	1%	27%	15%	37%	20%
Companies go public to make firm's products better known	4%	22%	13%	45%	16%
Companies go public to establish a value for the firm	9%	15%	21%	34%	21%
Original owners take their companies public to overcome the conflicts accruing between the owners about the leadership	11%	17%	18%	30%	24%
Firms go public because the government grants more subsidies to joint stock companies	10%	23%	11%	48%	8%
Companies go public because there are few resources of finance	3%	30%	22%	36%	9%
Firms go public because the government has allowed G.C.C citizens to own stocks in the Saudi Stock Market (SSM)	10%	22%	16%	48%	4%
Companies go public to use the money raised to pay their debt	3%	30%	27%	30%	10%
Firms go public because the government has allowed foreign investors to participate in the SSM through special funds established by commercial banks	11%	23%	22%	40%	5%
Companies go public to improve their credit rating	9%	24%	35%	24%	8%
Companies go public to motivate and create incentives to the management and employees	5%	38%	19%	30%	8%
Companies go public to avoid bankruptcy	11%	32%	20%	25%	12%
Original owners take their companies public when they know that the profitability is about to decline permanently (timing their offerings with high performance to sell their shares at a higher price)	8%	40%	17%	30%	6%
Firms go public because the government reduced the income tax rate	11%	36%	18%	28%	8%
Companies go public to evaluate and monitor management and employees	13%	28%	26%	28%	5%
Firms go public because the government eased the procedures for going public	13%	31%	24%	31%	2%
Companies go public to enhance their employees status	13%	41%	15%	31%	1%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

8.3.5.1 The effect of the participants' characteristics on their opinions on the motivations for going public in Saudi Arabia

Table 8-9 illustrates the result of the two independent sample t-test for the variable related to the motivations for going public. Based on the results presented in the table, significant differences were only observed in the nationality group. A statistically significant disagreement occurred between Saudis and non-Saudis over the statement that

"companies go public to improve their credit rating" (0.033 p-value). Comparing the means for both, Saudi participants agreed less with that statement, achieving means of 2.92, while non-Saudi participants agreed more, achieving means of 3.45. Furthermore, another significant difference occurred between Saudis and non-Saudis over "companies go public when there is a sharp stock price increase" (0.008 p-value). Saudis scored a 3.68 mean whereas non-Saudis scored 3.05. Finally, the two variables for "firms go public because the government grants more subsidies to joint stock companies" and "firms go public because the government has reduced the income tax rate" caused significant disagreements between Saudis and non-Saudis (0.002 and 0.030 p-values, respectively), Saudis scored the first with a 3.09 mean and the second 2.76, whereas non-Saudis scored the first with a 3.91 mean and the second 3.32.

The differences between Saudis and non-Saudis towards the motivations for going public could be because of differences in experiences, education, knowledge, culture, and position in the firm. Using the statement that firms go public because the government reduced the income tax rate as an example, Saudis rate this lower than their non-Saudi colleagues do. This difference might be accounted for by the fact that Saudis are not familiar with taxes. As has been discussed in Chapter Four, until now there are no taxes imposed on Saudi citizens but there is an income tax for non-Saudis. Therefore, non-Saudis are more concerned about the tax rate, and might see reductions in the income tax rate as a factor to encourage firms to go public.

Table 8-9 The two independent samples t-test result of differences between the respondents' opinions on the motivations for going public by nationality and field of study

Motivations	Nationality		Field of Study	
	T-test	P-value	T-test	P-value
Original owners take their companies public to liquidate part of their investment	0.531	0.596	-0.654	0.514
Original owners take their companies public to diversify part of their investment	0.675	0.501	-0.121	0.904
Original owners take their companies public to solve the problem of lack of family succession and control	-1.247	0.215	-0.105	0.917
Original owners take their companies public to overcome the conflicts accruing between the owners about the leadership	1.037	0.302	0.690	0.491
Original owners take their companies public when they know that the profitability is about to decline permanently (timing their offerings with high performance to sell their shares at a higher price)	1.202	0.231	-1.607	0.110
Companies go public to use the money raised for more expansion and growth	0.590	0.556	1.749	0.082
Companies go public to use the money raised to pay their debt	-0.026	0.980	0.339	0.735
Companies go public to improve their credit rating	-2.158	**0.033**	0.931	0.354
Companies go public to evaluate and monitor management and employees	-0.313	0.755	-0.524	0.601
Companies go public to motivate and create incentives to the management and employees	-0.591	0.555	-0.371	0.712
Companies go public to acquire and merge with other companies	-1.631	0.105	-0.359	0.720
Companies go public to enhance the company image and publicity	0.382	0.703	1.821	0.071
Companies go public to be recognised by investors	0.263	0.793	0.629	0.531
Companies go public to establish a value for the firm	-0.140	0.889	1.472	0.143
Companies go public to attract well qualified personal	0.341	0.733	1.824	0.070
Companies go public to make firm's products better known	-1.063	0.289	0.126	0.900
Companies go public to avoid bankruptcy	0.522	0.602	-0.611	0.542
Companies go public to be more competitive	-0.513	0.609	0.645	0.520
Companies go public to enhance their employees status	1.268	0.207	-0.440	0.661
Companies go public when they are overvalued by outside investors	1.256	0.211	0.033	0.973
Companies go public when there is a sharp stock price increase	2.693	**0.008**	0.534	0.594
Companies go public because there are few resources of finance	-1.102	0.272	0.221	0.826
Companies go public because the competition in their market is severe	-0.517	0.606	-0.822	0.413
Firms go public because the government eased the procedures for going public	-1.912	0.058	-1.164	0.246
Firms go public because the government grants more subsidies to joint stock companies	-3.090	**0.002**	-1.151	0.252
Firms go public because the government reduced the income tax rate	-2.186	**0.030**	1.811	0.072
Firms go public because the government has allowed the G.C.C citizens to own stocks in the Saudi Stock Market (SSM)	-1.601	0.112	0.860	0.391
Firms go public because the government has allowed the foreign investors to participate in the SSM through special funds established by commercial banks	-1.198	0.233	1.495	0.137

Bold and underlined figures refer to a 5% significant difference.

Table 8-10 shows the one-way ANOVA results of the differences between the respondents' opinions on the motivations for going public according to age, position, and degree. It can be seen from table 8-10 that significant differences are detected in the age and position groups. It seems that there are disagreements between age groups towards three motivations. The first motivation they disagreed about was "original owners take their companies public to overcome the conflicts accruing between the owners about leadership" (0.025 p-value). Managers aged less than 30 years old achieved a 2.60 mean,

aged between 30 and 40 achieved a 3.33 mean, aged between 41 and 50 achieved a 3.31 mean, aged between 51 and 60 achieved a 3.83 mean, and aged more than 60 achieved a 4.30 mean. These results are perhaps not surprising. As managers become older the preservation of the business becomes more immediate.

The second motivation the age groups differed about was "companies go public to improve their credit rating" (0.014 p-value). Managers aged less than 30 achieved a 2.40 mean, aged between 30 and 40 achieved a 3.00 mean, aged between 41 and 50 achieved a 3.18 mean, aged between 51 and 60 achieved a 3.22 mean, and aged more than 60 achieved a 2.10 mean. As managers become older the impact of credit rating increases but by the time they are turned 60, aspects such as continuity of the business becomes more important.

The third difference detected between the age groups was about "companies go public because there are few resources of finance" (0.000 p-value). Managers aged less than 30 achieved a 4.00 mean, aged between 30 and 40 achieved a 2.84 mean, aged between 41 and 50 achieved a 3.15 mean, aged between 51 and 60 achieved a 2.40 mean, and aged more than 60 achieved a 2.40 mean.

In the position group, just one difference was observed. Participants disagreed about "companies go public to acquire and merge with other companies" (0.002 p-value). Presidents had a mean score of 3.64, vice presidents had a mean score of 3.38, financial managers had a mean score of 3.25, and other positions had a mean score of 4.58.

Table 8-10 One-way ANOVA result of differences between the respondents' opinions towards motivations of going public by age, position, and degree

Motivations	Age		Position		Degree	
	F-test	P-value	F-test	P-value	F-test	P-value
Original owners take their companies public to liquidate part of their investment	0.091	0.985	1.061	0.368	0.019	0.982
Original owners take their companies public to diversify part of their investment	0.558	0.694	0.108	0.956	0.011	0.989
Original owners take their companies public to solve the problem of lack of family succession and control	0.923	0.453	0.178	0.911	0.098	0.906
Original owners take their companies public to overcome the conflicts accruing between the owners about the leadership	2.875	**0.025**	2.321	0.078	1.744	0.179
Original owners take their companies public when they know that the profitability is about to decline permanently (timing their offerings with high performance to sell their shares at a higher price)	1.925	0.110	0.065	0.978	1.491	0.229
Companies go public to use the money raised for more expansion and growth	2.154	0.077	1.457	0.229	1.261	0.287
Companies go public to use the money raised to pay their debt	0.341	0.850	0.533	0.660	0.669	0.514
Companies go public to improve their credit rating	3.269	**0.014**	1.122	0.342	0.319	0.727
Companies go public to evaluate and monitor management and employees	1.444	0.223	2.579	0.056	0.828	0.439
Companies go public to motivate and create incentives to the management and employees	1.881	0.117	2.188	0.092	0.253	0.776
Companies go public to acquire and merge with other companies	0.649	0.628	5.333	**0.002**	1.219	0.299
Companies go public to enhance the company image and publicity	0.654	0.625	0.750	0.524	1.399	0.250
Companies go public to be recognised by investors	1.175	0.324	0.346	0.792	0.145	0.865
Companies go public to establish a value for the firm	1.069	0.374	1.576	0.198	2.528	0.083
Companies go public to attract well qualified personal	1.245	0.295	1.851	0.141	0.963	0.384
Companies go public to make firm's products better known	0.837	0.504	1.998	0.117	0.106	0.900
Companies go public to avoid bankruptcy	1.576	0.184	0.488	0.691	1.982	0.142
Companies go public to be more competitive	1.876	0.118	1.927	0.128	0.061	0.941
Companies go public to enhance their employees status	1.289	0.277	2.298	0.080	1.925	0.150
Companies go public when they are overvalued by outside investors	1.727	0.147	0.358	0.783	0.409	0.665
Companies go public when there is a sharp stock price increase	1.344	0.257	1.634	0.184	0.986	·0.375
Companies go public because there are few resources of finance	5.531	**0.000**	1.365	0.256	0.278	0.758
Companies go public because the competition in their market is severe	2.066	0.088	0.240	0.868	0.634	0.532
Firms go public because the government eased the procedures for going public	0.289	0.885	2.290	0.081	2.854	0.061
Firms go public because the government grants more subsidies to joint stock companies	1.356	0.252	1.720	0.166	0.684	0.506
Firms go public because the government reduced the income tax rate	1.882	0.117	1.668	0.177	0.096	0.908
Firms go public because the government has allowed the G.C.C citizens to own stocks in the Saudi Stock Market (SSM)	0.324	0.861	1.406	0.243	0.519	0.596
Firms go public because the government has allowed the foreign investors to participate in the SSM through special funds established by commercial banks	1.034	0.392	0.712	0.546	1.692	0.188

Bold and underlined figures refer to a 5% significant difference

For two of the above motivations about which there is disagreement, it seems that managers who are less than thirty and manager who are more than sixty have very different views. This suggests that age-related thinking has an important role to play. For example, managers aged above sixty believe that original owners taking their companies public to overcome the conflicts accruing between owners about leadership is a major

motivation of going public in the Kingdom, while managers aged below thirty do not think so.

8.3.5.2 The participants' views of the motivations for going public by the firms' characteristics

Table 8-11 illustrates the one-way ANOVA result of differences between the respondents' opinions on the motivations for going public according to the firms' sector, legal status, age, and the number of employees. From the results presented in Table 8-11, it can be said that statistical significant differences are detected in all groups except legal status.

With regard to sector, significant differences are observed in three motivations. Firstly, there is disagreement that "companies go public to establish a value for the firm" (0.018 p-value). Comparing the means, companies working in the agricultural sector have a mean score of 3.86, in contracting a mean score of 3.33, in the trading sector a mean score of 3.30, in the financial sector a mean score of 4.33, in services a mean score of 2.56, in manufacturing a mean score of 3.44, and in diversified sectors a mean score of 3.63.

Secondly, there is also disagreement that "companies go public to attract well qualified personal" (0.042 p-value). From the means, companies working in the agricultural sector have a mean score of 3.86, in contracting a mean score of 4.00, in trading a mean score of 3.26, in the financial sector a mean score of 2.67, in services a mean score of 2.94, in manufacturing a mean score of 3.56, and in diversified sectors a mean score of 3.73.

Thirdly, significant differences detected in this group are from "companies go public to enhance employee status" (0.004 p-value). Comparing the means, companies operating in the agricultural sector have a mean score of 3.14, in contracting a mean score of 3.22, in trading a mean score of 2.68, in the financial sector a mean score of 2.00, in services a mean score of 1.83, in manufacturing a mean score of 2.74, and in diversified sectors a mean score of 2.86.

Significant differences are also detected between the group for the age of the firm, with regard to four motivations. Firstly, companies have varied views about "companies go public to improve their credit rating" (0.002 p-value). By comparing the means for this motivation, the mean for companies aged less than 10 years is 4.17, 3.21 for companies aged from 10 to 20 years, 3.14 for companies aged from 21 to 30 years, 2.50 for companies aged from 31 to 40 years, and 2.85 for companies aged more that 40 years.

Secondly, companies have significant difference towards "companies go public to evaluate and monitor management and employees" (0.019 p-value). From the means for this motivation, companies aged less than 10 years have a mean score of 3.50, 3.36 for companies aged from 10 to 20 years, 2.59 for companies aged from 21 to 30 years, 2.72 for companies aged from 31 to 40 years, and 2.79 for companies aged more that 40 years.

Table 8-11 One-way ANOVA result of differences between the respondents' opinions on the motivations for going public by firms' sector, legal status, age, and the number of employees

Motivations	Sector		Legal Status		Age		Employees No.	
	F-test	P-value	F-test	P-value	F-test	P-value	F-test	P-value
Original owners take their companies public to liquidate part of their investment	1.900	0.085	2.035	0.093	1.211	0.309	2.293	0.105
Original owners take their companies public to diversify part of their investment	1.409	0.215	0.483	0.748	1.282	0.280	0.667	0.515
Original owners take their companies public to solve the problem of lack of family succession and control	0.379	0.892	1.452	0.220	1.122	0.349	2.093	0.127
Original owners take their companies public to overcome the conflicts accruing between the owners about the leadership	1.392	0.222	1.059	0.379	0.589	0.671	0.237	0.789
Original owners take their companies public when they know that the profitability is about to decline permanently (timing their offerings with high performance to sell their shares at a higher price)	1.279	0.271	1.807	0.131	1.906	0.113	0.016	0.984
Companies go public to use the money raised for more expansion and growth	0.382	0.889	0.403	0.806	1.318	0.266	0.593	0.554
Companies go public to use the money raised to pay their debt	1.806	0.102	1.521	0.199	1.511	0.202	6.674	**0.002**
Companies go public to improve their credit rating	0.793	0.577	0.327	0.860	4.407	**0.002**	0.805	0.449
Companies go public to evaluate and monitor management and employees	1.530	0.173	0.935	0.446	3.048	**0.019**	2.683	0.072
Companies go public to motivate and create incentives to the management and employees	1.623	0.145	0.271	0.896	0.848	0.497	0.623	0.538
Companies go public to acquire and merge with other companies	2.110	0.056	0.091	0.985	1.852	0.122	1.089	0.339
Companies go public to enhance the company image and publicity	1.480	0.189	2.069	0.088	3.983	**0.004**	2.310	0.103
Companies go public to be recognised by investors	0.709	0.643	1.618	0.173	1.247	0.294	0.991	0.374
Companies go public to establish a value for the firm	2.654	**0.018**	2.082	0.086	0.524	0.718	0.959	0.386
Companies go public to attract well qualified personal	2.245	**0.042**	1.866	0.120	0.733	0.571	2.098	0.126
Companies go public to make firm's products better known	1.749	0.114	1.961	0.104	0.602	0.662	1.380	0.255
Companies go public to avoid bankruptcy	0.113	0.995	1.167	0.328	1.397	0.238	0.394	0.675
Companies go public to be more competitive	0.623	0.712	0.534	0.711	2.190	0.073	0.489	0.615
Companies go public to enhance their employees status	3.367	**0.004**	2.218	0.070	2.049	0.091	9.187	**0.000**
Companies go public when they are overvalued by outside investors	1.230	0.295	0.844	0.499	1.978	0.101	2.619	0.076
Companies go public when there is a sharp stock price increase	1.194	0.313	0.650	0.628	0.991	0.415	2.750	0.067
Companies go public because there are few resources of finance	0.761	0.602	1.791	0.134	0.493	0.741	0.214	0.808
Companies go public because the competition in their market is severe	1.107	0.361	0.875	0.481	2.739	**0.031**	1.606	0.204
Firms go public because the government eased the procedures for going public	0.623	0.711	0.756	0.556	1.519	0.200	1.240	0.292
Firms go public because the government grants more subsidies to joint stock companies	1.297	0.263	0.799	0.528	0.837	0.504	0.362	0.697
Firms go public because the government reduced the income tax rate	0.444	0.848	0.122	0.975	1.228	0.302	1.764	0.175
Firms go public because the government has allowed the G.C.C citizens to own stocks in the Saudi Stock Market (SSM)	2.178	0.056	0.293	0.882	0.487	0.745	0.896	0.410
Firms go public because the government has allowed the foreign investors to participate in the SSM through special funds established by commercial banks	0.908	0.491	0.763	0.551	1.514	0.201	0.408	0.665

Bold and underlined figures refer to a 5% significant difference.

Thirdly, companies disagree significantly about the motivation "companies go public to enhance the company image and publicity" (0.004 p-value). Comparing the means for this motivation, the mean for companies aged less than 10 years is 4.67, 3.93 for companies aged from 10 to 20 years, 3.37 for companies aged from 21 to 30 years, 3.87 for companies aged from 31 to 40 years, and 3.29 for companies aged more that 40 years.

Fourthly, companies differ about the motivation "companies go public because competition in their market is severe" (0.031 p-value). From the means for this motivation, companies aged less than 10 years have a mean score of 3.50, 3.43 for companies aged from 10 to 20 years, 3.43 for companies aged from 21 to 30 years, 3.97 for companies aged from 31 to 40 years, and 3.04 for companies aged more that 40 years. This suggests that companies which have been in business longer have lower means than those with a shorter time in business.

There are two differences in the groupings for number of employees. Companies have a statistically significant difference about the motivation "companies go public to use the money raised to pay their debt" (0.002 p-value). Companies employing less than 500 employees have a mean score of 3.27, 2.80 for from 500 to 1000 employees, and 3.67 for more than 1000 employees. The second difference occurs from the motivation "companies go public to enhance employee status" (0.000 p-value). Companies employing less than 500 employees have a mean score of 3.03, 2.57 for from 500 to 1000 employees, and 1.95 for more than 1000 employees. Interestingly, the higher the number of employees in companies, the less companies think that companies go public to enhance employee status.

Finally, from the findings presented in this section, it can be concluded that Saudi firms are motivated to go public for different reasons. However, the strategic reasons, like using the money for growth, and personal reasons, such as liquidating part of the original owners' investments are the most significant motivations. Moreover, the managerial motives, like enhancing the employees status, have little support.

8.3.6 The barriers to going public in Saudi Arabia

The participants were asked in Part Two, Question Ten of the questionnaire about possible barriers which would reduce the rate of going public in the Kingdom. Twenty-two possible barriers were listed, and the participants stated their views by using the 5-point Likert Scale.

Table 8-12 shows the rank, means, standard deviations, and coefficient of variations, of all possible barriers to going public in Saudi Arabia. "The failure of many joint stock companies listed in the SSM to generate profits" was ranked as the first commonly agreed barrier in the Kingdom (4.028 mean, 0.971 SD and 0.241 CV). There was also general agreement amongst the respondents with having the smallest CV. "Owners avoid going public because of the possible loss of control" ranked the second highest barrier with 3.821 mean, 1.065 SD, and 0.279 CV. The third highest constraint reducing the rate of IPOs was "fear of more restrictions on private transactions," scoring a mean of 3.655, SD of 1.057, and CV of 0.289. "Stock market is not open completely for international investors" was ranked the fourth highest barrier in the Kingdom (3.594 mean, 1.115 SD and 0.310 CV), with "unwelcome attention regarding a possible takeover" ranked the highest fifth barrier with 3.559 mean, 1.079 SD, and 0.303 CV.

Finally, the participants ranked the barrier "there is no complete financial system" as the sixth highest constraint with 3.462 mean, 1.213 SD and 0.350 CV, and "restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company" as the seventh highest constrain with 3.400 mean, 1.151 SD, and 0.339 CV.

Table 8-12 Ranks, means, standard deviations (SD), and coefficients of variation (CV) of the barriers to going public in Saudi Arabia

Barriers	Rank	Mean	SD	CV
The failure of many joint stock companies listed in the SSM to generate profits	1	4.028	0.971	0.241
Owners avoid going public because of the possible loss of control	2	3.821	1.065	0.279
Fear of more restrictions on private transactions	3	3.655	1.057	0.289
Stock market is not open completely for international investors	4	3.594	1.115	0.310
Unwelcome attention regarding a possible takeover	5	3.559	1.079	0.303
There is no complete financial system	6	3.462	1.213	0.350
Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	7	3.400	1.151	0.339
Lack of experience about the legal and financial points related to the IPO	8	3.345	1.139	0.341
More disclosure requirements	9	3.338	1.075	0.322
The difficulty of determining the real value of the firm	10	3.264	1.177	0.361
The ambiguity in regulations that cover fundamental IPO issues	11	3.241	1.101	0.340
External investor scrutiny	12	3.146	1.223	0.389
Fear that the offer price might be less than market price in the first day	13	3.145	1.099	0.349
Liquidity in the Saudi Market is limited	14	3.139	1.210	0.385
Dividend pressure	15	3.138	1.116	0.356
Restricted regulations from the Department of Zakat and Income Tax	16	3.090	1.073	0.347
Expenses and fees associated with the procedures of going public are high	17	2.958	0.981	0.332
Fear of the increase of agency costs	18	2.862	1.058	0.370
Owners avoid going public because of the possible negative impact on their relationships with managers and employees	19	2.848	1.198	0.421
There are few underwriters in the country	20	2.834	1.137	0.401
The lack of well experienced personnel who can manage companies after transition	21	2.690	1.071	0.398
Income tax rate is high	22	2.607	0.967	0.371

Table 8-13 shows the percentage of responses regarding the barrier to going public in Saudi Arabia. A majority - 78% of respondents - agreed or strongly agreed, and none strongly disagreed with the opinion that firms do not go public because of "the failure of many joint stock companies listed in the SSM to generate profits".

Almost as many respondents (72%) agreed or strongly agreed with "owners avoid going public because of the possible loss of control", while 68% of respondents agreed or

strongly agreed with that firms do not go public because of "fear of more restrictions on private transactions". A further 66% of the participants agreed or strongly agreed with that firms do not go public because "the stock market is not open completely for international investors", whereas 72% of the participants agreed or strongly agreed that firms do not go public because of "unwelcome attention regarding a possible takeover." Still a majority, 56% of participants agreed or strongly agreed that firms do not go public because "there is no complete financial system", and 52% of participants agreed or strongly agreed that firms do not go public because of "restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company".

Table 8-13 Percentage of responses regarding the barriers to going public in Saudi Arabia

Barriers	1	2	3	4	5
The failure of many joint stock companies listed in the SSM to generate profits	0%	12%	10%	41%	37%
Owners avoid going public because of the possible loss of control	4%	9%	15%	44%	28%
Fear of more restrictions on private transactions	3%	17%	12%	49%	19%
Stock market is not open completely for international investors	6%	14%	15%	47%	19%
Unwelcome attention regarding a possible takeover	5%	18%	6%	59%	13%
There is no complete financial system	3%	27%	13%	33%	23%
Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	6%	17%	25%	34%	18%
Lack of experience about the legal and financial points related to the IPO	6%	21%	17%	42%	13%
More disclosure requirements	3%	26%	13%	48%	10%
The difficulty of determining the real value of the firm	4%	30%	18%	31%	17%
The ambiguity in regulations that cover fundamental IPO issues	3%	29%	23%	31%	14%
External investor scrutiny	10%	27%	10%	43%	10%
Fear that the offer price might be less than market price in the first day	3%	32%	21%	32%	11%
Liquidity in the Saudi Market is limited	6%	35%	11%	35%	13%
Dividend pressure	8%	27%	16%	43%	6%
Restricted regulations from the Department of Zakat and Income Tax	6%	27%	30%	28%	10%
Expenses and fees associated with the procedures of going public are high	4%	32%	38%	19%	8%
Fear of the increase of agency costs	7%	39%	18%	32%	3%
Owners avoid going public because of the possible negative impact on their relationships with managers and employees	11%	38%	15%	27%	9%
There are few underwriters in the country	7%	44%	17%	23%	9%
The lack of well experienced personnel who can manage companies after transition	11%	41%	18%	27%	3%
Income tax rate is high	10%	37%	39%	8%	6%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

At last, the Saudi business environments played the most crucial role in preventing firms from making IPO, since the low performance of Saudi JSCs making private firms hesitant to make entry to the SSM. Moreover, general barriers, such as losing the control, which are recorded in other countries, contributed to the low number of IPOs in the Kingdom.

8.3.6.1 The effect of the participants' characteristics on their opinions about the barriers to going public in Saudi Arabia

Table 8-14 shows the results of the two independent sample t-test for the factors related to the barrier to going public in the Kingdom. Based on the t-test results presented in table 8-14, there are significant differences observed only in the grouping for field of study. The first difference occurs between participants towards the factor that "there are few underwriters in the country" (0.000 p-value). The people whose field of study is business scored a mean of 2.61, whereas others scored 3.33. The second significant difference between participants is towards the factor "the stock market is not open completely for international investors" (0.030 p-value). People whose field of study is business scored a mean of 3.46, whereas others scored 3.90.

Table 8-14 The two independent samples t-test result of differences between the respondents' opinions about the barriers to going public by nationality and field of study

Barriers	Nationality		Field of Study	
	T-test	P-value	T-test	P-value
Owners avoid going public because of the possible negative impacts on their relationships with managers and employees	-1.423	0.157	-0.495	0.621
Owners avoid going public because of the possible loss of control	1.319	0.189	0.330	0.742
Fear of more restrictions on private transactions	0.967	0.335	-1.273	0.205
Lack of experience about the legal and financial points related to the IPO	-1.101	0.273	0.997	0.320
The lack of well experienced personnel who can manage companies after transition	-0.610	0.543	0.146	0.884
Fear of the increase of agency costs	0.867	0.388	0.813	0.417
External investor scrutiny	0.796	0.427	-0.741	0.460
Dividend pressure	0.007	0.994	0.109	0.913
Unwelcome attention regarding a possible takeover	-1.443	0.151	0.598	0.551
Fear that the offer price might be less than market price in the first day	0.670	0.504	-1.066	0.288
The difficulty of determining the real value of the firm	0.158	0.875	0.267	0.790
Liquidity in the Saudi Market is limited	0.178	0.859	-1.930	0.056
There are few underwriters in the country	0.683	0.496	-3.579	**0.000**
There is no complete financial system	1.178	0.241	-1.601	0.112
Stock market is not open completely for international investors	1.477	0.142	-2.199	**0.030**
The failure of many joint stock companies listed in the SSM to generate profits	0.859	0.392	-0.206	0.837
Expenses and fees associated with the procedures of going public are high	0.255	0.799	0.111	0.911
Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	0.160	0.873	1.877	0.063
Restricted regulations from the Department of Zakat and Income Tax	-1.085	0.280	0.903	0.368
More disclosure requirements	0.523	0.602	-1.374	0.172
The ambiguity in regulations that cover fundamental IPO issues	0.275	0.784	-0.041	0.967
Income tax rate is high	0.802	0.424	-0.943	0.348

Bold and underlined figures refer to a 5% significant difference.

Table 8-15 demonstrates the one-way ANOVA results of differences between the respondents' opinions towards the barriers to going public according to their age, position, and degree. It can be seen from Table 8-15 that significant differences are detected in all groups. However, these differences do not occur systematically in the table. Moreover, there is little disagreement.

In the age group, three significant differences are identified. Firstly, participants disagreed about the factor "firms do not go public because of the fear that the offer price might be less than market price on the first day" (0.016 p-value).

Table 8-15 One-way ANOVA result of differences between the respondents' opinions about the barriers to going public according to their age, position, and degree

Barriers	Age		Position		Degree	
	F-test	P-value	F-test	P-value	F-test	P-value
Owners avoid going public because of the possible negative impacts on their relationships with managers and employees	0.252	0.908	1.180	0.320	0.531	0.589
Owners avoid going public because of the possible loss of control	0.787	0.535	2.536	0.059	2.136	0.122
Fear of more restrictions on private transactions	0.990	0.415	0.146	0.932	3.143	0.046
Lack of experience about the legal and financial points related to the IPO	1.420	0.231	1.169	0.324	1.160	0.316
The lack of well experienced personnel who can manage companies after transition	1.315	0.267	0.878	0.454	1.705	0.185
Fear of the increase of agency costs	1.335	0.260	0.091	0.965	2.833	0.062
External investor scrutiny	1.337	0.259	2.289	0.081	2.782	0.065
Dividend pressure	1.196	0.315	1.883	0.135	2.074	0.129
Unwelcome attention regarding a possible takeover	0.102	0.982	0.114	0.952	2.987	0.054
Fear that the offer price might be less than market price in the first day	3.172	**0.016**	1.494	0.219	0.562	0.571
The difficulty of determining the real value of the firm	1.129	0.345	0.618	0.604	0.014	0.986
Liquidity in the Saudi Market is limited	1.897	0.114	1.815	0.147	2.557	0.081
There are few underwriters in the country	0.348	0.845	0.922	0.432	1.780	0.172
There is no complete financial system	0.788	0.535	1.354	0.260	0.392	0.676
Stock market is not open completely for international investors	0.873	0.482	3.290	0.023	0.610	0.545
The failure of many joint stock companies listed in the SSM to generate profits	0.827	0.510	0.189	0.904	0.500	0.608
Expenses and fees associated with the procedures of going public are high	0.279	0.891	1.212	0.308	3.464	0.034
Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	0.481	0.750	0.206	0.892	0.797	0.452
Restricted regulations from the Department of Zakat and Income Tax	0.783	0.538	0.096	0.962	1.138	0.323
More disclosure requirements	2.528	0.043	0.180	0.910	4.890	0.009
The ambiguity in regulations that cover fundamental IPO issues	2.896	0.024	2.521	0.060	1.739	0.179
Income tax rate is high	0.389	0.816	1.321	0.270	1.640	0.198

Bold and underlined figures refer to a 5% significant difference.

Managers aged less than 30 achieved a mean of 4.00, aged between 30 and 40 achieved 2.91, aged between 41 and 50 achieved 3.21, aged between 51 and 60 achieved 2.80, and aged more than 60 achieved 3.60.

This is perhaps surprising. People experienced in the stock market would know that prices move in an active market. It possibly reflects a belief that the SSM, as has been shown in Chapter Three, is not informationally efficient. But why it is related to age is difficult to comprehend.

Secondly, the participants disagreed about "firms do not go public because of more disclosure requirements" (0.043 p-value). Managers aged less than 30 had a mean score of 3.20, aged between 30 and 40 a score of 3.16, aged between 41 and 50 a score of 3.37, aged between 51 and 60 a score of 3.20, and aged more than 60 a score of 4.30. The result will be driven by the last observations. This is obvious that old participants think barrier of "more disclosure requirement" is so important one while younger participants do not think so. One possible explanation of this result is that the old manager, to some extent, are more restrictive toward revealing so much information about their business.

The third significant difference is detected in the factor "firms do not go public because of the ambiguity in regulations that cover fundamental IPO issues" (0.024 p-value). Managers aged less than 30 had a mean score of 3.60, aged between 30 and 40 a score of 3.58, aged between 41 and 50 a score of 3.18, aged between 51 and 60 a score of 2.80, and aged more than 60 a score of 2.70. The average is falling with age.

Moreover, Table 8-15 shows that there is another significant difference in the position group towards the factor that firms do not go public because "the stock market is not open completely for international investors" (0.023 p-value). The mean of presidents is 3.71, vice presidents is 3.73, financial managers is 3.25, and others is 2.75. This suggests a strategic awareness of this barrier.

Finally, other differences are detected in the degree group towards three barriers. The first difference is about companies do not go public because of "fear of more restrictions on private transactions" (0.046 p-value). People with less than a bachelor's degree have a

mean score of 3.14, those with a bachelor's degree have a score of 3.53, and postgraduate degrees have a score of 3.92. Again, suggesting awareness of the possibility.

The second difference is about companies do not go public because "expenses and fees associated with the procedures of going public are high" (0.034 p-value). People with less than a bachelor's degree have a mean score of 2.57, those with a bachelor's degree have a score of 2.82, and postgraduate degrees have a score of 3.23.

The third difference is about companies do not go public because of "more disclosure requirements" (0.009 p-value). People with less than a bachelor's degree have a mean score of 2.57, those with a bachelor's degree have a score of 3.21, and postgraduate degrees have a score of 3.65.

8.3.6.2 Participants' views of the barrier to going public by the characteristics of the firms

Table 8-16 illustrates the one-way ANOVA results of the differences between the respondents' opinions about the barriers to going public according to firms' sector, legal status, age, and the number of employees.

From the results presented in Table 8-16, it can be said that statistical significant differences are detected in all groups, three differences in the sector group, one difference in the legal status group, seven differences in the age group, and two differences in the

number of employees group. Interestingly, age group have seven differences from twenty two. However, these differences might occur because of the nature of ANOVA test[36].

Despite these differences, it is clear from Table 8-16 that there is common agreement between the participants according to their firms' characteristics towards most of the barriers listed.

Finally, it can be said from Tables 8-14, 8-15, and 8-16 that the respondents' and firms' characteristics have some effect on the perception of the barriers to going public in the Kingdom. However, these Tables show that most of the highest ranked barriers are accepted by all groups. There is a general consistency in views.

[36] As has been explained before in this chapter, ANOVA test is used to find if there were significant differences between the means of more than two independent variables. Moreover, the mean in general is strongly influenced by extreme observations and also the observations in each group (Table 8-6 showed that the distribution of participants in firms' age group is extreme).

Table 8-16 One-way ANOVA results of differences between the respondents' opinions about the barriers to going public according to firms' sector, legal status, age, and the number of employees

Barriers	Sector		Legal Status		Age		Employees No.	
	F-test	P-value	F-test	P-value	F-test	P-value	F-test	P-value
Owners avoid going public because of the possible negative impacts on their relationships with managers and employees	1.147	0.339	0.405	0.805	0.305	0.874	1.823	0.165
Owners avoid going public because of the possible loss of control	0.669	0.675	0.218	0.928	0.217	0.928	0.379	0.685
Fear of more restrictions on private transactions	1.150	0.337	0.703	0.591	2.421	0.051	0.449	0.639
Lack of experience about the legal and financial points related to the IPO	1.810	0.101	1.537	0.195	0.353	0.842	5.402	**0.005**
The lack of well experienced personnel who can manage companies after transition	1.256	0.282	2.505	**0.045**	1.680	0.158	1.787	0.171
Fear of the increase of agency costs	1.645	0.139	0.917	0.456	0.911	0.459	0.580	0.561
External investor scrutiny	0.425	0.861	0.499	0.736	3.621	**0.008**	1.117	0.330
Dividend pressure	1.421	0.211	2.029	0.094	2.300	0.062	0.551	0.578
Unwelcome attention regarding a possible takeover	1.701	0.125	1.948	0.106	1.763	0.140	0.791	0.456
Fear that the offer price might be less than market price in the first day	0.939	0.469	0.888	0.473	2.665	**0.035**	1.745	0.178
The difficulty of determining the real value of the firm	0.652	0.689	1.389	0.241	0.712	0.585	1.300	0.276
Liquidity in the Saudi Market is limited	1.970	0.074	1.680	0.158	0.063	0.993	0.489	0.614
There are few underwriters in the country	0.436	0.854	1.704	0.152	2.295	0.062	1.625	0.201
There is no complete financial system	0.651	0.690	1.502	0.205	1.876	0.118	0.449	0.639
Stock market is not open completely for international investors	0.917	0.485	1.181	0.322	3.427	**0.011**	0.110	0.896
The failure of many joint stock companies listed in the SSM to generate profits	1.550	0.166	0.896	0.468	1.589	0.181	0.075	0.928
Expenses and fees associated with the procedures of going public are high	2.305	**0.038**	1.147	0.337	5.463	**0.000**	3.750	**0.026**
Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	3.536	**0.003**	1.393	0.239	3.447	**0.010**	1.203	0.303
Restricted regulations from the Department of Zakat and Income Tax	3.107	**0.007**	0.992	0.414	2.998	**0.021**	2.881	0.059
More disclosure requirements	1.218	0.300	0.485	0.747	3.012	**0.020**	0.642	0.528
The ambiguity in regulations that cover fundamental IPO issues	1.765	0.111	1.714	0.150	1.067	0.375	0.674	0.511
Income tax rate is high	2.121	0.055	0.495	0.739	1.493	0.207	2.415	0.093

Bold and underlined figures refer to a 5% significant difference

8.3.7 The performance of IPOs after the transition

Question 12, part four, in the questionnaire asked respondents whether the profitability of IPOs after the transition would (A) increase, (B) decrease (C) not change, (D) do not know. The responses to this particular question are shown in Table 8-17.

It is clear from Table 8-17 that more participants believed that profitability declines after an IPO. It can be seen that 34.3% of the respondents believed that profitability of IPOs would increase after transition, 42.7% thought it would decrease, 14.6% believed it would not change, and 8.4% had no idea.

This result is perhaps surprising giving the earlier evidence on barriers to going public. In Table 8-12, the failure Saudi JSCs to make profits was seen as the major reason as a barrier to entry. Yet, here it is not that significant. A likely justification for this contradiction is that the participants here gave their perceptions about the future and they were slightly pessimistic. However, in the barrier section their opinions were based on real evidence, facts not expectations.

Table 8-17 Percentage of responses regarding perceptions of the profitability of IPOs after the transition

Answer	No.	%	Valid %
Profitability increases	49	33.8%	34.3%
Profitability decreases	61	42.1%	42.7%
Profitability do not change	21	14.5%	14.6%
Respondents do not know	12	8.3%	8.4%
Total Responded	**143**	**98.6%**	**100%**
Missing	2	1.4%	-
Total	**145**	**100%**	-

Respondents were asked about possible reasons for an increase or decrease in IPO performance. The reasons given are presented later in this chapter.

8.3.7.1 The effect of the characteristics of respondents and firms on perceptions of the performance of IPOs

Because this question is categorical, chi-square tests were employed and the results are presented in Table 8-18. It can be shown from the results shown in Table 8-18 that the respondents' ages (0.001 p-value), nationality (0.000 p-value), and the firms' legal status (0.000 p-value) had some effects on participants' answers to Question 12.

Firstly, in the age group, it seems that the younger people are less optimistic and support the idea that IPO profitability decreases after transition. Many (60%) respondents aged less than 30 years thought that IPO profitability would decrease, 20% thought it would not change, and 20% had no idea. Some 36% of respondents aged between 30 and 40 thought IPO profitability would increase, 50% thought it would decrease, 7% thought it would not change, and 7% had no idea. Slightly more, 39%, of respondents aged between 41 and 50 believed IPO profitability would increase, 47% believed it would decrease, 8% believed it would not change, and 7% had no idea. Some 37% of respondents aged between 51 and 60 believed IPO profitability would increase, 26% believed it would decrease, 26% believed it would not change, and 11% had no idea. Finally, 30% of respondents aged more than 60 thought IPO profitability would increase, 60% thought it would not change, and 10% had no idea.

Secondly, in the nationality group, by observing the percentages of both groups, it can be said that more Saudis are supportive of the idea that IPO profitability would decrease, while most non-Saudis thought IPO profitability would increase. Just 26% of Saudis believed IPO profitability would increase, 47% believed it would decrease, 17% believed it would not change, and 10% had no idea. In contrast, 77% of non-Saudis thought IPO

profitability would increase, 18% believed it would decrease, and 5% believed it would not change.

Finally, in the legal status group, most sole proprietorships support the idea that IPO profitability would decrease. Only 10% of these firms thought IPO profitability would increase, 65% thought it would decrease, 23% thought no change, and 3% had no idea. On the other hand, most partnerships thought the opposite. Most, 80%, of these firms believed IPO profitability would increase, whereas 20% believed it would decrease.

Table 8-18 Chi-square results of differences between the respondents' opinions on IPO performance by the characteristics of respondents and firms, and percentage of responses within group[37]

Category		The profitability of IPOs, after the transition, would				Test Results	
		Increase	Decrease	Do not Change	Do not Know	X^2	P-Value
Participants' Age	Less than 30 years	0%	60%	20%	20%	32.336	**0.001**
	From 30 to 40 years	36%	50%	7%	7%		
	From 41 to 50 years	39%	47%	8%	7%		
	From 51 to 60 years	37%	26%	26%	11%		
	More than 60 years	30%	0%	60%	10%		
Participants' Nationality	Saudi	26%	47%	17%	10%	21.688	**0.000**
	Other Nationalities	77%	18%	5%	0%		
Participants' Position	President (Manager)	31%	45%	15%	9%	4.984	0.836
	Vice President	31%	46%	12%	12%		
	Financial Manager	50%	33%	17%	0%		
	Other positions	50%	25%	17%	8%		
Participants' Level of Education	Less than Bachelor Deg.	43%	29%	29%	0%	6.271	0.394
	Bachelor Deg.	34%	44%	11%	12%		
	Postgraduate Deg.	34%	42%	20%	4%		
Participants' Field of Study	Business Studies	38%	40%	13%	8%	2.184	0.535
	Other Studies	26%	49%	16%	9%		
Firms' Sector	Agriculture	29%	71%	0%	0%	22.968	0.192
	Contracting	56%	22%	11%	11%		
	Trading	19%	67%	15%	0%		
	Financing	33%	67%	0%	0%		
	Services	47%	35%	12%	6%		
	Manufacturing	41%	37%	15%	7%		
	Diversified	32%	32%	20%	16%		
Firms' Legal Status	Sole Proprietorship	10%	65%	23%	3%	41.052	**0.000**
	Partnership	80%	20%	0%	0%		
	Liability Partnership	0%	57%	14%	29%		
	Limited Liability	45%	27%	18%	10%		
	Joint Stock	38%	50%	0%	13%		
Firms' Age	Less than 10 years	17%	83%	0%	0%	20.00	0.067
	From 10 to 20 years	43%	46%	7%	4%		
	From 21 to 30 years	39%	41%	10%	10%		
	From 31 to 40 years	41%	38%	19%	3%		
	More than 40 years	14%	39%	29%	18%		
Number of Employees	Less than 500 Emp.	43%	44%	10%	3%	9.187	0.163
	From 500 to 1000 Emp.	28%	38%	20%	13%		
	More than 1000 Emp.	25%	50%	15%	10%		

Bold and underlined figures refer to a 5% significant difference. X^2 is chi-square result

8.3.7.2 Reasons for improving IPO performance

Question 13 in the questionnaire asked respondents who believed IPO profitability would increase after the transition to indicate how strongly they agreed or disagreed with seven reasons that could positively affect IPO profitability. The responses to this question are demonstrated in Tables 8-19 and 8-20.

[37] Within group percentage is used because it is not affected by the number of respondents in each group.

Tables 8-19 and 8-20 clearly show that most reasons are supported by participants. The overall mean scores, illustrated in Table 8-19, indicate that the reason "after transition, management and employees become shareholders giving them more incentive to work harder" (a mean score of 4.367) is perceived as the reason with most agreement for improving IPO performance, followed by "after transition, IPOs hire professional personnel to lead the companies" (4.204); "the change in the ownership structure" (4.125); "after transition, IPOs grow more" (4.102); "after transition IPOs diversify their business" (3.898); "IPO products and names get more publicity" (3.837); and "the interest rates IPOs are charged decrease" (3.490).

Table 8-19 Ranks, means, standard deviations (SD), and coefficients of variations (CV) of the reasons for improvement in IPO performance in Saudi Arabia

Reasons for Improving Performance	Rank	Mean	SD	CV
After transition, management and employees become shareholders giving them more incentives to work harder	1	4.367	0.528	0.121
After transition, IPOs hire professional personnel to lead the companies	2	4.204	0.676	0.161
The change in the ownership structure	3	4.125	0.606	0.147
After transition, IPOs grow more	4	4.102	0.797	0.194
After transition, IPOs diversify their business	5	3.898	0.941	0.241
IPOs' products and names get more publicity	6	3.837	0.825	0.215
Interest rate that IPOs are charged decreases	7	3.490	0.893	0.256

The CV in Table 8-19 shows that there is relatively little disagreement about the importance of these factors. This is also showing in Table 8-20. Table 8-20 shows the percentage of people who agreed or disagreed with the factors that positively affect IPO profitability. Almost all participants (98%) either agreed or strongly agreed that IPO profitability improves after transition because management and employees become shareholders giving them more incentives to work harder. Almost as many, 94%,

participants agreed or strongly agreed that IPO profitability increases after transition because IPOs hire professional personnel to lead the companies. Another strong majority, 92% of participants, agreed or strongly agreed that IPO profitability improves after transition because of the change in the ownership structure. The same proportion of 92% agreed or strongly agreed that IPO profitability increases after transition because IPOs grow more. Slightly less unanimously, 81% of participants agreed or strongly agreed that IPO profitability improves after transition because IPOs' products and names get more publicity. Finally, 76% of participants agreed or strongly agreed that IPO profitability improves after transition because IPOs diversify their business, whereas 59% of participants agreed or strongly agreed that IPO profitability increases after transition because the interest rates IPOs are charged decrease.

Table 8-20 Percentage of responses regarding the reasons for improvement in IPO performance in Saudi Arabia

Reasons for Improving the Performance	1	2	3	4	5
After transition, management and employees become shareholders giving them more incentives to work harder	0%	0%	2%	59%	39%
After transition, IPOs hire professional personnel to lead the companies	0%	4%	2%	63%	31%
The change in the ownership structure	0%	2%	6%	69%	23%
After transition, IPOs grow more	2%	4%	2%	65%	27%
After transition, IPOs diversify their business	0%	12%	12%	49%	27%
IPOs' products and names get more publicity	0%	12%	6%	67%	14%
Interest rate, that IPOs are charged, decreases	0%	18%	22%	51%	8%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

8.3.7.3 The reasons for a decline in IPO performance

Question 14 in the questionnaire asked the respondents who believed IPO profitability decreases after the transition to point out how strongly they agreed or disagreed with six given reasons that would have negative effects on IPO profitability.

From Tables 8-21 and 8-22, it is clear from the mean score that most of the reasons are supported by participants. The strongest agreement came from the factor "the controlling shareholders and top managers give themselves more privileges (increase their salaries, bonuses, etc)" (mean score 4.200). The second strongest reason affecting performance negatively was "the original owners time their IPO with high performance" with a mean score of 3.902. The third was "IPOs invest in long-term projects which pay off after a few years" with a mean score of 3.869. The fourth was "IPOs witness changes in the ownership structure" with a mean score of 3.557. The fifth was "controlling shareholders and the top managers pay their private expenses from the company's money" with a mean score of 3.443, and the sixth was "IPOs witness increases in agency costs which occur due to the increased conflict between the shareholders and management" with a mean of 3.082.

There is some overlap between the questions where there is a conflict between shareholders and managers. What this demonstrates is that the tension between shareholders and managers over different objectives for the company is very important.

Table 8-21 Ranks, means, standard deviations (SD), and coefficient of variation (CV) of the reasons for a reduction in performance of IPOs in Saudi Arabia

Reasons Reducing the Performance	Rank	Mean	SD	CV
The controlling shareholders and top managers give themselves more privileges (increase their salaries, their bonuses. etc)	1	4.200	0.732	0.174
The original owners time their IPO with high performance	2	3.902	1.028	0.263
IPOs invest in long-term projects which payoff after a few years	3	3.869	1.024	0.265
IPOs witness changes in the ownership structure	4	3.557	1.041	0.293
Controlling shareholders and the top managers pay their private expenses from the company's money	5	3.443	1.232	0.358
IPOs witness increases in agency costs which occur due to the increased conflict in between the shareholders and the management	6	3.082	1.173	0.381

Table 8-22 illustrates the percentage of respondents who agreed or disagreed with the reasons negatively affecting IPO profitability. Most - 91% - participants agreed or strongly agreed that IPO profitability decreases after transition because "the controlling shareholders and top managers give themselves more privileges (increase their salaries, bonuses, etc.)". Many (74%) respondents agreed or strongly agreed that IPO profitability decreases after transition because "the original owners time their IPO with high performance". The same proportion of participants (74%) agreed or strongly agreed that IPO profitability declines after transition because "IPOs invest in long-term projects which pay off after a few years". Two-thirds (67%) of respondents agreed or strongly agreed that IPO profitability decreases after transition because "IPOs witness changes in the ownership structure". A little over half of participants (59%) agreed or strongly agreed that IPO profitability declines after transition because "controlling shareholders and the top managers pay their private expenses from the company's money". Less than half of participants (39%) agreed or strongly agreed that IPO profitability decreases after transition because "IPOs witness increases in agency costs which occur due to the increased conflict between shareholders and the management".

Table 8-22 Percentage of responses regarding the reasons for a reduction in the performance of IPOs in Saudi Arabia

Factors Reducing the Performance	1	2	3	4	5
The controlling shareholders and top managers give themselves more privileges (increase their salaries, their bonuses. etc)	0%	5%	3%	58%	33%
The original owners time their IPO with high performance	5%	3%	18%	44%	30%
IPOs invest in long-term projects which payoff after a few years	0%	13%	13%	48%	26%
IPOs witness changes in the ownership structure	3%	18%	12%	54%	13%
Controlling shareholders and the top managers pay their private expenses from the company's money	8%	18%	15%	39%	20%
IPOs witness increases in agency costs which occur due to the increased conflict in between the shareholders and the management	7%	31%	23%	26%	13%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

8.3.8 The effect of an increased number of joint stock companies on the Saudi economy

Whether an increased number of joint stock companies in the Saudi Stock Market would have either a positive or negative impact on the economy was examined in Question 15, part five, in the questionnaire.

Tables 8-23 and 8-24 illustrate clearly that participants thought that an increased number of IPOs in the Kingdom would have beneficial effects on five economic factors. The overall mean scores, in Table 8-23, show that economic growth (mean score 4.175) is considered to be the factor with the most positive effect from an increased number of IPOs, followed by "international investments" (3.944); "the balance of trade" (3.909); "the competition in the market" (3.895); and "the unemployment rate" (3.804).

However, Table 8-23 also shows that the statement that an increased number of IPOs would positively affect interest and inflation rates was not greatly supported by respondents, who were neutral about them. Interest rates had a mean score of 3.113 and the inflation rate had a mean score of 3.000. This is not surprising. These macroeconomic variables are expected to be controlled by the government (as has been shown in Chapter Two).

Table 8-23 Ranks, means, standard deviations (SD), and coefficients of variation (CV) of the effect of an increased number of IPOs on the Saudi economy

Economic Factors	Rank	Mean	SD	CV
Economic growth	1	4.175	0.685	0.164
International investment	2	3.944	0.809	0.205
The balance of trade	3	3.909	0.871	0.223
The competition in the market	4	3.895	0.925	0.237
The unemployment rate	5	3.804	1.023	0.269
Interest rates	6	3.113	1.025	0.329
The inflation rate	7	3.000	1.003	0.334

In addition, Table 8-24 demonstrates that 90% of the respondents agree or strongly agree that the growth rate will be positively affected by an increased number of IPOs in the Kingdom.

Table 8-24 Percentage of responses regarding the effect of an increased number of IPOs on the Saudi economy

Economic Factors	1	2	3	4	5
Economic growth	1%	1%	8%	60%	30%
International investment	0%	8%	10%	60%	22%
The balance of trade	0%	11%	11%	55%	23%
The competition in the market	1%	10%	15%	49%	26%
The unemployment rate	6%	7%	9%	58%	20%
The interest rate	4%	30%	26%	34%	7%
The inflation rate	4%	33%	31%	26%	7%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

Most participants (82%) agreed or strongly agreed that international investment was positively affected by an increased number of IPOs. Some 78% of respondents agreed or strongly agreed that the balance of trade was positively correlated with an increased number of IPOs, and the same proportion agreed or strongly agreed that an increase in IPOs would affect the unemployment rate positively. A majority (75%) of respondents agreed or strongly agreed that competition in the market was positively influenced by an increased number of IPOs, but a minority (41%) of participants agreed or strongly agreed

that an increase in IPOs would affect interest rates positively. Only 33% of respondents agreed or strongly agreed that an increase in IPOs would affect the inflation rate positively.

8.3.9 The characteristics of companies going public in Saudi Arabia

Question 16, part five, in the questionnaire asked participants to rate which kind of companies would be more likely to go public. The purpose of this question was to find if there was an association between the decision to go public and types of companies. Eleven kinds of companies with specific characteristics were listed, and participants were asked to indicate how strongly they agreed or disagreed by using a 5-point Likert Scale, from 1= strongly disagree to 5= strongly agree. Tables 8-25 and 8-27 show the responses to this question. The mean scores, the standard deviations, and the coefficients of variation are shown in Table 8-25 and the frequency of responses is shown in Table 8-27.

Table 8-25 Ranks, means, standard deviations (SD), and coefficients of variation (CV) of the characteristics of IPOs in Saudi Arabia

Characteristics of the IPOs	Rank	Mean	SD	CV
Companies owned by more than one investor	1	4.083	0.722	0.177
Large companies (in terms of size)	2	3.958	1.074	0.271
High growth companies	3	3.862	1.052	0.272
Companies working in very competitive industries	4	3.807	0.810	0.213
Well-known companies	5	3.800	1.031	0.271
Manufacturing companies	6	3.676	0.813	0.221
Profitable companies	7	3.600	1.169	0.325
Overvalued companies	8	3.517	1.131	0.322
Old companies (in terms of age)	9	3.076	1.161	0.377
Very risky companies	10	2.818	1.085	0.385
Companies having a huge amount of debt	11	2.814	1.149	0.408

It is obvious from the mean scores in Table 8-25 that respondents think "companies owned by more than one investor" are the most likely to go public in Saudi Arabia (a mean score of 4.083)

"Large companies (in terms of size)" came second with a mean score of 3.958, with "high growth companies" third with a score of 3.862. "Companies working in very competitive industries" came fourth with a mean score of 3.807, and "well-known companies" fifth with a score of 3.800, "manufacturing companies" sixth with a score of 3.676, "profitable companies" seventh with a score of 3.600, and "overvalued companies" eighth with a score of 3.517. Finally, the ninth, tenth, and eleventh ranked were "old companies (in terms of age)" "very risky companies," and "companies having a huge amount of debt" with, respectively, scores of 3.076, 2.818, and 2.814.

Table 8-26 shows the percentage of responses regarding the characteristics of IPOs in the Kingdom.

Table 8-26 Percentage of responses regarding the characteristics of IPOs in Saudi Arabia

Characteristics of the IPOs	1	2	3	4	5
Companies owned by more than one investor	0%	4%	10%	60%	26%
Large companies (in terms of size)	4%	11%	3%	50%	32%
High growth companies	2%	15%	5%	50%	28%
Companies working in very competitive industries	1%	7%	19%	57%	16%
Well-known companies	1%	18%	3%	55%	23%
Manufacturing companies	1%	9%	23%	57%	11%
Profitable companies	6%	18%	9%	46%	21%
Overvalued companies	4%	19%	17%	41%	19%
Old companies (in terms of age)	6%	37%	13%	35%	10%
Very risky companies	8%	40%	18%	30%	4%
Companies having a huge amount of debt	11%	34%	28%	18%	10%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

Many respondents (86%) agreed or strongly agreed that "companies owned by more than one investor" were more likely to go public, and almost as many (82%) agreed or strongly agreed that "large companies, in terms of size," were more likely to go public,

and 78% of participants agreed or strongly agreed that "high growth companies" were more likely to go public.

Finally, the results here are consistent with the findings in earlier sections. For instance, it has been revealed in the motivation for going public section that companies are motivated the most to enter the stock market to use the money raised for more growth and here in this section participants believed that "high growth companies" amongst the most likely to go public in the country. Moreover, the finding in this section are supported by the existing literature, such as Matsuda *et al.* (1994), who found that at the time of the IPOs, companies were large.

8.3.10 Suggestions to improve the rate of going public in Saudi Arabia

The final question, part six, in the questionnaire asked participants to rate thirteen listed suggestions that might improve the rate of going public in Saudi Arabia.

Tables 8-27 and 8-28 show that respondents supported most of the suggestions listed. Eight of the thirteen suggestions had mean scores between 4.00 and 4.50 and the other five had mean scores between 3.500 and 4.00. The results suggest that the Saudi government and private firms could have an effective role in encouraging companies to go public.

The highest level of agreement came from the suggestion that "the Saudi government should create a complete financial system" with a mean score of 4.379. The second highest was "the Saudi government should prepare clear guidelines that explain the procedures for going public" with a mean score of 4.352, with "the decision makers in

private firms should separate management from ownership and hire professional personnel to lead the companies" was third with a mean score of 4.262. Fourth and fifth were "the Saudi government should ease the regulations for firms willing to go public" and "the decision makers in private firms should reshape companies' organisational structure" both with mean scores of 4.255.

This is not surprising result. As Chapter Four has discussed, the regulations regarding the financial system in general and the procedures of going public in particular are not comprehensive and clear. Moreover, they cover only some of the issues related to the IPOs.

Table 8-27 Ranks, means, standard deviations (SD), and coefficients of variation (CV) of the suggestions to improve the rate of going public in Saudi Arabia

Suggestions to Improve the Rate of Going Public	Rank	Mean	SD	CV
The Saudi government should create complete financial system	1	4.379	0.718	0.164
The Saudi government should prepare clear guidelines that explain the procedures for going public	2	4.352	0.672	0.154
The decision makers in private firms should separate management from ownership and hire professional personnel to lead the companies	3	4.262	0.858	0.201
The Saudi government should ease the regulations for firms willing to go public	4	4.255	0.664	0.156
The decision makers in private firms should reshape companies' organisational structure	5	4.255	0.675	0.159
The Saudi government should allow non-Saudi investors to participate freely in the SSM	6	4.166	0.890	0.214
The Saudi government should ease the regulations for firms and persons willing to be underwriters	7	4.069	0.839	0.206
The decision makers in private firms should disclose more information about their companies' activities and financial status to the public	8	4.021	0.768	0.191
The decision makers in private firms should enrol in some training programmes which may increase their knowledge about IPO issues	9	3.916	0.835	0.213
The Saudi government should allow banks to invest in the SSM	10	3.869	1.107	0.286
The decision makers in private firms should increase their companies' size	11	3.706	1.020	0.275
The Saudi government should grant IPOs more subsidies	12	3.524	1.214	0.344
The Saudi government should allow foreign companies to be listed in the SSM	13	3.500	1.171	0.335

Table 8-28 Percentage of responses regarding the suggestions to improve the rate of going public in Saudi Arabia

Suggestions to Improve the Rate of Going Public	1	2	3	4	5
The Saudi government should create complete financial system	0%	2%	8%	41%	50%
The Saudi government should prepare clear guidelines that explain the procedures for going public	0%	1%	9%	45%	46%
The decision makers in private firms should separate management from ownership and hire professional personnel to lead the companies	1%	5%	4%	46%	44%
The Saudi government should ease the regulations for firms willing to go public	0%	2%	6%	56%	36%
The decision makers in private firms should reshape their companies' organisational structure	0%	2%	7%	55%	37%
The Saudi government should allow non-Saudi investors to participate freely in the SSM	1%	6%	12%	41%	41%
The Saudi government should ease the regulations for firms and persons willing to be underwriters	1%	3%	19%	43%	34%
The decision makers in private firms should disclose more information about their companies' activities and financial status to the public	1%	3%	16%	55%	26%
The decision makers in private firms should enrol in some training programmes which may increase their knowledge about the IPO issues	0%	6%	20%	49%	25%
The Saudi government should allow banks to invest in the SSM	2%	15%	10%	39%	34%
The decision makers in private firms should increase companies' size	4%	9%	18%	49%	20%
The Saudi government should grant IPOs more subsidies	6%	21%	13%	37%	23%
The Saudi government should allow foreign companies to be listed in the SSM	7%	14%	21%	37%	20%

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

8.4 Results from the interviews (qualitative methodology)

The researcher was able to meet three more respondents who had taken their companies public, to discuss the research questions in depth. The interviews were transcribed and used in this study to supplement and confirm the discussion of the overall results and findings, which will be presented in next chapter. However, it should be said here that, the information reported in this section is so important because it contains the rich experience and real cases from people who lived with the decision of going public, step-by-step. A summary of the findings is shown in Table 8-29.

Table 8-29 Summary of the interview results

Study Variables	Company's Name		
	Al-Zamil	Al-Rajhi	Amiantit
A- Motivation			
Liquidate part of their investment	√		√
Diversify part of their investment	√		√
Use the money raised for expansion and growth	√		√
Attract well qualified personnel	√		√
Move from non-professional management to very professional	√		√
Create financial strength			√
Increase public trust		√	√
Increase lenders' trust			√
Separate the company's life from the owners' (continuity of the company)	√	√	√
protect small shareowners' rights			√
B- Barriers			
Convincing original owners of the idea of going public	√		
Market doubt about the real reasons behind the decision	√		
The disclosure	√		
The procedure was very long			√
C- Advantages			
Liquidate, easily, part of their investments	√		√
Entered their name in the history	√		
Attract well qualified personnel	√		√
Improve credit rating	√		
Gain more recognition from the public and investors			√
Gain more trust from customers		√	
Being listed on the stock market works as advertising			√
D- Disadvantages			
Sensitivity toward the volatility of the share prices	√		
Inflexibility of using the cash in other activities rather than the company's	√		
Disclosure			√
E- Effects			
The effect of going public on profitability	Positive	Positive	Nothing
Debt level after the IPO	Does not change	-------	Decrease
The borrowing cost after the IPO	Decrease	------	Nothing
The effect of going public on growth	Positive	Positive	Positive
The effect of going public on the diversification of the business	Positive	------	Positive
The ownership structure after the IPO	Does not change	Does not change	Does not change
The effect of going public on the competition	Nothing	Positive	Nothing
F- An increase in the number of Joint Stock companies affects positively the following economic factors:	Positively	Positively	Positively
Economic growth	√		
Unemployment rates	√		√
Attract international investors	√	√	√
New investment channels		√	√
Increase competition			√
G- The decision to go public is associated with particular kinds of companies	Industrial and Service	Industrial and Agricultural	Any kind of farm can go public
H- Suggestions to increase the number of IPOs in Saudi			
Issue complete financial system	√		
Go public gradually	√		
Ease the procedure		√	√
Support industrial, investment, and export funds			√
Support small and medium-sized businesses			√
Privatise some governmental companies			√
Train more people (increase the human resources)			√
Increase the information and statistical figures in the country by making more studies and creating more specialised institutions			√

8.4.1 First interview

The first interview was with Dr. Abdulrahman A. Al-Zamil, one of the owners and the chairman of the Al-Zamil Group. He was also the deputy Commerce Minister and is now a member of the Saudi Shura Council (Parliament). His company went public in 1998 after floating 40% of its shares to Saudi and Gulf investors (for more information about the company, please see Chapter Three). Dr. Al-Zamil's views are also really important because they are likely to be influential at the governmental level.

8.4.1.1 Motivation for the Saudi IPO

Dr. Al-Zamil said the most important motivation was continuity of the company. According to Dr. Al-Zamil, some studies made by respected institutions, show that family businesses, if they are not joint stock companies, tend to disappear by the third generation. Also, any owner of a private company can freeze the business at any time. However, if the company is joint stock, no one can stop the business. Therefore, he said, when his company went public, he can be sure now that the business will continue and he is still managing the company. If any shareholder has complaints or doubts, they can sell their stock or start a campaign to collect votes to change the management, but they cannot freeze the business. However, it can be argued that while the legal status of a JSC can guarantee that conflict between owners would not stop the business, it does not protect from the possibility of bankruptcy as a result of bad performance, or from a takeover, as the company is listed in the stock market.

The second motivation he mentioned, was to liquidate part of their investment. He added that the family sold 40% of their company and used the money to create other companies in the petrochemical and other sectors in Saudi Arabia. As the literature review, Chapter 5, showed, personal reasons are strong motivators, and the original owners of the Al-Zamil Company were so motivated to make their IPO. They reinvested their money in different businesses to reduce risk in their portfolio.

Dr. Al-Zamil said the third motivation was to attract people with good experience to help them manage the company. Dr. Al-Zamil claimed that the new owners are from well-organised and very respected companies, such as the Al-Olian Group, the Bn Mahfoz Group, and the International Gulf Bank. All these names are on the board of directors. He added that if these organisations were not owners, the company could not benefit from their experience, even if it paid millions. This improves the network of contacts for the firm. This point is significant since it has not previously mentioned in the existing literature.

Dr. Al-Zamil also said, "*the fourth motivation, which we talked about for a long time, was to move our management from being non-professional to very professional. We are trying to split ownership from management*". The status of JSC could facilitate the achievement of this goal. However, splitting ownership from management would not reduce the influence of owners on the management, since the original owners still hold 60% of the shares. There are still seven of the eleven original owners from the Al-Zamil family on the board of directors, and Dr. Al-Zamil still is the chairman.

8.4.1.2 Barriers to a Saudi IPO

In response to the researcher's question, Dr. Al-Zamil listed some barriers they faced when they decided to go public. The most important barrier, he said, which slowed down the process of going public, was convincing the original owners of the idea. Some were cautious about bringing in new owners. They said that their business was doing well and they did not need to sell some of their shares to the public and also disclose information. However, with time and negotiation, Dr. Al-Zamil said, they were able to overcome this barrier.

The second barrier was market doubt about the real reasons behind their decision, he said. He added, "*some people in the market thought that we were selling some of our shares because we were failing and wanted to get rid of the company. However, once they realised that we were selling just 40% of the shares and were keeping the rest, this doubt disappeared*". Such concern by the market is normal, as the public has the idea that no one would sell a company if it is performing well. Keeping the majority of shares at the IPO may not be enough to assure the public, because the original owners can still sell their shares after listing. Therefore, some more significant assurance is required, such as company performance, market share, and management.

The third barrier was sociological. Most of the original owners did not want to disclose company information to the public. Dr. Al-Zamil believes that Saudis are not used to revealing to others their financial position, such as profit and loss.

8.4.1.3 Advantages of the Saudi IPO

When Dr. Al-Zamil was asked about the advantages of being a Joint Stock Company, he replied that "*the most important advantage was that when we went public, we, the original owners, made a great deal of money. As I said, we sold 40% of the shares, SR 520 million. We invested this money in new businesses. We established, with others, the International Petrochemical Company with a capital of SR 1.5 billion. This money also helped us to diversify our portfolios*". It seems from the stated motivations and advantages that providing cash for the original owners to invest in other opportunities is the real reason for the IPO. The owners were looking to personally diversify their holding.

Dr. Al-Zamil also claimed that the second advantage, once the company became listed on the Saudi Stock Market, is that it gave the family name a place in history. He said: "*as long as the Saudi Stock Market is there, our name will also be there. This accomplishment is priceless*". Interestingly, this advantage has nothing to do with the company performance or the original owners' wealth. There is no doubt that the basic decision to go public was taken for personal and corporate reasons. However, the original owners can gain more publicity from an IPO, so not everything they did was just for money.

According to Dr. Al-Zamil, the third advantage was that because the company is now joint stock, they were able to attract very good staff. He said: "*we cannot do this if the company is not joint stock, because these people do not want to always work in a company controlled and owned by one person and be at his or her mercy*".

The fourth advantage, Dr. Al-Zamil mentioned, is that lenders have much more trust in the company. People do not always notice this advantage, he said. Trust is greater in joint stock companies because it involves dealing with an independent company with independent decisions and financial status. Trust is also increased because joint stock companies disclose all the necessary information, he said. Nevertheless, being a JSC does not mean that the company is entirely independent. There are some cases in Saudi Arabia where one owner holds more than 80% of the JSC's shares. For example, Mr. Ahmed Fitaihi owns 85% of the Fitaihi Company's shares.

8.4.1.4 Disadvantages of the Saudi IPO

His answer to the question as to whether he thinks that IPOs may have some disadvantages was 'yes'. The most important disadvantage he believes is that shareowners are very sensitive towards the volatility of the share price. He said, "*when the price goes up, everyone is happy and welcomes the decision – but also vice versa*".

The second disadvantage he mentioned was that the owners do not have the right to use the cash available to the company, in areas different from the activities of the company. An example he gave: "*a piece of land is under offer at a really good price, and if you buy it and keep it even for a short time, you can sell it at a very good profit. However, you cannot buy it because trading in properties is not the purpose of the company. Missing such good opportunities is a very high price paid by the owners*". In other words, there is no flexibility in using the cash in activities different from the stated activities of the company. However, the flexibility in using the cash in the activities of the company is very high, he said. On the other hand, these strict regulations concerning the use of the

company's cash in activities other than the company's stated business could be seen as a protection from any misbehaviour by the management.

8.4.1.5 Effects of the IPO on the company

His comments on the effects of going public on the profitability of the company were that the market is the real determinant of profitability. He claimed "*immediately after we transferred to being a public company, our profit was good. However, in the second and third years, our profit decreased because the price of raw materials increased, and the selling price of products also decreased (for external reasons). Now our profit is returning to its previous level because the price of raw materials has decreased*".

Dr. Al-Zamil's comments on the effects of going public on the debt level or capital structure of the company were that there were no policy changes toward the capital structure nor the debt level. Moreover, he thinks the interest rate payable on debt strongly decreased after the IPO. He said: "*all the banks now want to finance our activities because they know everything about the company. Every three months, we disclose all the financial statements, which show what is going on and where the company is going. Banks know that there is a board of directors responsible and they know that when they lend the company some money, the company will use it for the specific purpose for which it is lent*".

In addition, he believes the growth of the company increased after the IPO. He said, "*our sales increase continuously. When we went public our sales were SR 900 million and are now SR 1,400 million. Because of disclosure, we are now facing a huge challenge that we*

have to increase our sales as well as our profits. Before going public, nobody knew about our sales and profits except us. Now, we have meetings every month to find out whether we are going in the right direction or not and every three months we publish our financial statement". Dr. Al-Zamil made an interesting point here that disclosure boosted their sales. However, he had previously mentioned that some of the original owners were reluctant to go public because of the disclosure requirements. Therefore, disclosing the company's financial reports could be considered as a positive factor, since the publicly visible results encourage the management to work harder. In addition, he thinks the IPO helped them to diversify their business. After they went public, he claimed that they had more cash and more sources are willing to finance their activities. This cash helped to diversify the business and make it grow.

According to Dr Al-Zamil, the ownership structure and control did not change. The original owners have 60% of the shares and they will not sell or buy more shares now or in the future. Regarding the effect of the IPO on the competition, he replied, "*our position in the market has not been affected by the decision to go public. Our market is harsh and those who offer lower prices will be competitive. Prices are the determinant*".

8.4.1.6 Effects of an increased number of Saudi IPOs on the economy

Dr Al-Zamil's opinion about whether an increase in the number of Joint Stock companies would affect the Saudi economy is that an increase would have a very positive effect. He said: "*one of the weakest points in our economy is that there are not a large number of joint stock companies. 93% of all shares on the Saudi Stock Market are owned by the government, large financial institutions, and some wealthy families, and only 7% of the*

shares are traded in the market. Because of this, the market cannot attract new investors. This is ridiculous. We have to encourage more companies to go public. The Saudi Stock Market can have at least 1,000 joint stock companies. Now, we just have 71. This is silly". He thinks an increase in the number of joint stock companies would have a positive effect on growth and unemployment rates. For example, his group created the International Petrochemical Company as a joint stock company and it employs hundreds of people and these companies helped also to attract international investors. Dr. Al-Zamil added that joint stock companies are one of the most important factors in the economy. There is no doubt about it, he said.

8.4.1.7 Characteristics of the Saudi IPOs

In response to the researcher's question about whether the decision to go public is associated with particular kinds of companies, Dr Al-Zamil claimed that, in Saudi Arabia, manufacturing companies are the best placed to go public. They are accepted by the market because they have visible assets. Companies working in the services sector could also go public and be accepted by the market. However, manufacturing companies are more capable and accepted, he claimed. This is an interesting perspective on the role of intangible assets in being able to successfully market a company on the SSM.

8.4.1.8 Suggestions to increase the rate of Saudi IPOs

Finally, when Dr. Al-Zamil was asked to give some suggestions as to what would improve the rate of going public, he replied that there are some steps which should be taken. Firstly, he said, most original owners are sensitive to the disclosure issue. To deal

with this problem, companies willing to go public could go gradually. They could become closed joint stock companies. When they become closed joint stock companies, they do not have to be forced to disclose their information because they do not sell their stock to the public. After some time, the original owners would psychologically gain more confidence. At that point they would have no problem in disclosing their information and with the idea of going public.

Dr. Al-Zamil also thinks the overall financial system will have a great effect on the number of joint stock companies. It will encourage more companies to go public. In addition, clear guidelines that explain the procedures for going public are very important, he said.

8.4.2 Second interview

Mr. Sulaiman A. Al-Rajhi was the second interviewee. According to Forbes Magazine in 2003, Al-Rajhi was number 192 in the list of the world's richest people and number 7 of Saudi's richest people. His bank switched to public equity, with an initial capital of SR 750 million in 1988 (for more information about the company, please see Chapter Three).

8.4.2.1 Motivations for the IPO

Mr. Al-Rajhi claimed that behind the IPO, the first and most important motivation was to keep the business going (continuity of the company). The second motivation was to gain public trust. He said, "*because our business is banking, public trust is essential. We want the public to feel that the bank is their bank. Listing the bank on the stock market helps us to reach this goal*". It seems that they have reached this goal, as the Al-Rajhi Banking

and Investment Corporation is now one of the largest joint stock companies in the Kingdom, with a net profit of more that SR 2 billion in 2003, and has the largest branch network (more than 500 branches) distributed throughout the Kingdom.

8.4.2.2 Barriers to a Saudi IPO

According to Mr. Al-Rajhi, they had no barriers. He said, "*there was consensus between the original owners about taking the bank public and the governmental bodies were co-operative. So we had no noticeable barriers*"

8.4.2.3 Advantages of the Saudi IPO

His comments on the advantages of being a joint stock company were that having more customers is the most important advantage. He also claimed that the IPO made it more competitive because the trust of the customers increased dramatically. In fact it was not only the IPO that made it more competitive. The most important reason, making the Al-Rajhi Bank number one in the country in terms of size, branches, profit, and customers, is that it is the only bank to provide a full range of Islamic financial products, which is widely popular among Muslims. Recently, some banks started to introduce this kind of service to customers. For example, Al-Jazira Bank announced in May 2004 that it switched all its banking services to be consistent to Islamic laws.

8.4.2.4 Disadvantages of the Saudi IPO

Mr. Al-Rajhi claimed that he could not find any major disadvantages caused by the IPO.

8.4.2.5 Effects of the IPO on the company

He thinks that going public has had a positive impact on the profitability and growth of the bank. He also claimed that the ownership structure and control did not change after the IPO. He said, "*8 out of the 14 people making up the board of directors are the original owners. So, we still have control*".

8.4.2.6 Effects of an increased number of Saudi IPOs on the economy

In response to the researcher's question about whether an increase in the number of Joint Stock Companies would affect the Saudi economy, Mr. Al-Rajhi thought that the effect would be very positive. He said, "*the increase in the number of JSCs will help the economy greatly. Investors will have new investment channels, the unemployment rate will decrease, and new international investors will be happy to enter the Saudi market*".

8.4.2.7 Characteristic of the Saudi IPOs

Mr. Al-Rajhi believes that manufacturing and agricultural firms are more capable of going public than others, because these kinds of companies are what the Kingdom needs these days.

8.4.2.8 Suggestions to increase the rate of Saudi IPOs

Finally, he claimed that if the government eased the procedures for going public, this would increase the number of IPOs in the country.

8.4.3 Third interview

The third interview was held with Mr. Khalid Al-Rabiaah, the general manager for administration and finance in the Saudi Arabian Amiantit Company, which converted to a Saudi Joint Stock Company in January 1994 (for more information about the company, please see Chapter Three).

8.4.3.1 Motivations for the Saudi IPO

Mr. Al-Rabiaah claimed that one of the motivations was to create financial strength. He said, "*we decided to go public to use the money raised for more expansion. And also going public gives us the ability to finance our future growth by selling more stocks to the public*".

The second motivation he mentioned, was to gain public trust. He thinks that JSC's are more respected because they are controlled by specific rules and owned by many investors.

He also believes that the third motivation was to separate the life of the company from the life of the owners. He thinks that the existence of the private companies is always connected to the owners, and private companies are always disappearing because of internal problems. However, JSCs have clear policies and strategies. They are separate from the owners. They have general meetings, separate managements, and internal auditing committees.

The fourth motivation, Mr. Al-Rabiaah stated, was to protect small shareowners' rights. This is because the JSC's follow strict rules and regulations, which give smaller shareholders the same rights as any other owners. In addition, he claimed that the fifth motivation was to gain lenders' trust. He stated, "*lenders prefer to finance JSC's because they know that these kinds of companies work under specific laws*".

8.4.3.2 Barriers to a Saudi IPO

When Mr. Al-Rabiaah was asked about the barriers of going public, he replied that they did not face any major barriers except that the procedure took a long time. The decision to go public was a strategic one to the owners and they worked very hard from the beginning to achieve this goal, he claimed.

8.4.3.3 Advantages of the IPO

Regarding the advantages of going public, Mr. Al-Rabiaah believes that going public gave them more recognition from both the public and investors. Being listed on the stock market works as advertising, he said. Moreover, he thinks that after the IPO they can acquire well-qualified people willing to work for them.

8.4.3.4 Disadvantages of the IPO

In response to the researcher's question about whether there are some disadvantages in being a JSC, He said, "*the disclosure. When we went public, we had to publish our financial statements. Competitors obtain information such as our margins, debt, borrowing capacity, and profit from these financial statements, and use them to compete*

with us better, especially if the competitors are not JSC's". Nonetheless, even if competitors did obtain some financial information about the company, that would not necessarily harm the company once it produces products and goods of good quality at competitive prices. Interestingly, Mr. Al-Rabiaah sees disclosure as a disadvantage, whereas Dr. Al-Zamil sees disclosure as a tool to enhance the company's growth.

8.4.3.5 Effects of the IPO on the company

Mr. Al-Rabiaah claimed that the IPO had no noticeable effect on profitability. This statement is surprising, given the earlier comments from Mr. Al-Rabiaah that they went public to expand the business, and the IPO made them more recognisable, worked an as advertising tool, and also attracted more well-qualified people.

In addition, after the IPO, the company becomes less dependent on external debt. Regarding the effect on interest rates, he thinks that the interest rate depends on the risk and the risk depends on many factors. One of the factors is the legal structure of the company. However, there are more important factors such as the company's performance, management, and debt level. He stated, "*being a JSC helps us to get cheaper interest rates but it is not the major reason. We think the influence of other factors is the reason*". He also believes that the IPO has had a positive impact on the growth of the company. In addition, the IPO helped them to diversify within their business (vertical diversification).

Regarding the ownership structure after the IPO, he claimed that the ownership structure did not change dramatically and control is still in the hands of the original owners.

Furthermore, he believes that the IPO has had no major effect on the competition. Before and after going public, they are the leader in their market, he said.

8.4.3.6 Effects of an increased number of Saudi IPOs on the economy

When Mr Al-Rabiaah was asked if he thought that an increase in the number of Joint Stock Companies would affect the Saudi economy, he replied that an increase would help to create a market that is more competitive. Investors will have more investment channels. It will help to create more jobs and attract international investors.

8.4.3.7 Characteristics of the Saudi IPOs

Mr. Al-Rabiaah does not think that the decision to go public is associated with particular kinds of companies. He said, "*I believe all companies are able to go public regardless of their business or sector. I think the Ministry of Commerce does not prevent any kind of business from going public if they fulfil the requirements*".

8.4.3.8 Suggestions to increase the rate of Saudi IPOs

Mr. Al-Rabiaah made some suggestions which would improve the rate of going public. These suggestions were to:

- Increase the information and statistical figures available in the country by conducting more research and creating more specialised institutions
- Support the industrial, investment, and export funds
- Support small and medium-sized businesses
- Privatise some governmental companies

- Train more people (increase human resources)

8.5 Summary

This chapter consisted of three parts. The first part discussed and defined the statistical techniques employed in this study, the second part discussed and presented the results obtained from the questionnaire, and the third part showed the results obtained from the interviews.

The key objective of this study was to investigate several themes in going public in Saudi Arabia. This study revealed the motivations of going public, the barriers to going public, the effect of going public on a firm's performance and on the economy, the characteristics of IPOs, and recommendations to improve the rate of IPOs in the Kingdom.

The findings and results from the questionnaire can be summarised as follows:

1. Companies are motivated to go public to use the money raised for more expansion and growth and to be more competitive.
2. Private firms in the Kingdom are reluctant to go public because of the failure of many joint stock companies listed in the Saudi Stock Market to generate profit and also because of the possible loss of control.
3. 42.7% of participants, the largest single grouping, believed IPO performance would decline after the transition.

4. The people, who believed IPO performance would increase, thought the main reason for this improvement was management and employees become shareholders, giving them more incentive to work harder.
5. The people, who believed IPO performance would decline, thought the main reason for this decrease was that the controlling shareholders and top managers give themselves more privileges (increase their salaries, bonuses, etc.).
6. An increase in joint stock companies in the Kingdom would improve several economic factors, such as the growth rate, foreign investment, the balance of trade, and the unemployment rate.
7. Companies owned by more than one investor and large companies (in terms of size) are more likely to go public.
8. Creating a complete financial system and preparing clear guidelines that explain the procedures for going public would help to increase the rate of going public in Saudi Arabia.

Furthermore, the findings and results from the interviews can be summarised as follow:

1. Interviewees were motivated to go public to separate the company's life from the owners'.
2. They faced some barriers when they went public, such as the due procedure being very long.
3. Interviewees believed that the IPO gave them several advantages such as liquidating easily part of their investments, and improving the company's credit rating.

4. They also thought that the IPO caused some disadvantages, such as disclosure.
5. Most interviewees claimed that the performance of their companies improved after the transition.
6. The interviewees said that ownership structure does not change after an IPO.
7. They also claimed that growth in their companies was positively affected by the IPO.
8. They said that they diversified their businesses after the IPO.
9. Most of them did not believe that the IPO decision had any effect on the competition.
10. The interviewees thought that an increase in joint stock companies in the Kingdom would improve several economic factors, such as international investment, the growth rate, and the unemployment rate.
11. Companies working in the industrial sector are more likely to go public.
12. An easing in the procedure for going public would help to increase the rate of going public in Saudi Arabia.

By observing the findings of the questionnaire and interviews, there are great consistencies between all the participants toward the IPO activities in the Kingdom. However, there is a one major difference between the questionnaire participants and the interviewees toward the performance of the IPOs. While the questionnaire respondents believed the performance of the IPOs would decrease, the interviewees believed the opposite.

9.1 Introduction

The main thrust of this thesis is to investigate IPO activity in Saudi Arabia. As has been discussed in Chapter Six (the methodology chapter), the researcher intended to study IPO activity by investigating many case studies. The researcher posted letters to all companies that went public in the country asking if they were willing to cooperate with the researcher and provide all the necessary documents and posted a letter to the Ministry of Commerce asking if they could provide the researcher with such information Unfortunately, only one company acceded to the researcher's request and posted the required documents. Besides the single case study, the researcher therefore decided to use two other methods (a questionnaire and interviews) to achieve the study objectives.

Chapter Six also shows that several measures were taken to ensure the reliability and validity of the information obtained from both the questionnaire and the interview. For example, the participants in both the questionnaire and the interviews were well-experienced and educated in the issues studied, since many of them had witnessed the IPO. In addition, the questionnaire and interviews covered the essential points identified in the literature review. Moreover, the questionnaire and the interview were tested, revised, and improved based on the opinions of many people. Finally, the results from the questionnaire were very close to the results obtained from the interviews, indicating a strong degree of validity.

As has been seen in the last two chapters, the quantitative and qualitative analysis provided a useful understanding of the problems studied. In this chapter, the researcher discusses, justifies, and links the findings and results obtained from a single case study, personal interviews, and a questionnaire with previous researches and also the Saudi business and cultural environment.

This chapter is divided into six parts. The first part presents and justifies the findings and results regarding the motivations for going public and the second discusses and explains the barriers to going public. The third talks about the performance of IPOs, while the fourth discusses and justifies the relationship between IPOs and the economy. The fifth presents and explains the characteristics of IPOs, and finally the sixth part presents suggestions which may increase the rate of IPOs.

9.2 Motivations for going public in Saudi Arabia

The findings obtained from the case study, the questionnaire, and the interviews show that strategic, economic (maximising the owners wealth), and personal motivations all play a leading role in making firms in Saudi Arabia take the decision to go public. Firms are motivated to go public to finance their future expansion and growth, to be more competitive, and to merge with or acquire other firms. In addition, the original owners make this decision to gain more flexibility in liquidating and diversifying their investments and also to solve the problem of lack of family succession and control. On the other hand, owners do not make this decision for reasons related to the regulations in the Kingdom nor related to employees. Firms do not go public to enhance employee status or motivate, evaluate, monitor, and create incentives for them. Moreover, firms do

not go public because the government reduced the income tax rate or eased the procedures for going public. Finally, motivations related to the Saudi market such as the idea that "companies go public when they are overvalued by outside investors" got little support.

Unsurprisingly, "companies go public to use the money raised for more expansion and growth" was the most common motivation for going public amongst the questionnaire participants and all five interviewees. However, the financial ratio analysis, in the single case study, showed that the Saudi IPO under investigation actually grew more in the period prior to the IPO.

Firstly, it was shown in the literature review (Chapter 5) that many studies, such as Ransley (1984) and Rydqvist and Högholm (1995), found supporting evidence that growth is one of the most important motives. Without the IPO, companies would be financially constrained.

In the case of Saudi Arabia, there is some justification for this outcome. One likely explanation is that Saudi Arabia is a growing country in many respects. Firstly, it is a large country, and has one of the highest population growth rates in the world, increasing by an estimated 4.0% per year (Business Monitor International Ltd., 1993). Projections from the population census indicate that the overall population of the Kingdom will increase by 56.6% during the period 2000-2020, while the population of Saudi nationals will increase by almost 90% over the same period (Ministry of Planning, 2003). This population increase has substantial implications for the growth in demand for basic services in various fields. Secondly, Saudi Arabia has the largest market for products and

services in the Arab world and has access to GCC markets as well as other Arab countries through its participation in free-trade zones (Jasimuddin, 2001). Thirdly, most cities and towns are also growing rapidly. Thus, businesses operating in the Kingdom try to have a presence in every possible part of the country. Fourthly, the majority of firms are small or medium sized and of recent origin, which means that they are in the development and growth stages, and therefore usually require funding to finance their activities.

One more justification for this result is that many enterprises without the IPO face difficulties in meeting the requirements for loans and other types of credit from banks and government specialised credit institutions, limiting their access to finance for future projects and weakening their investment plans. This has been recognised in Saudi Arabia (see Ministry of Planning, 2002). Moreover, chapter Two showed that one of the major problems the private sector faces in Saudi Arabia is constraints of finance. Therefore, going public can help them to provide the necessary funding as well as strengthening their financial position.

Another possible explanation is that the Saudi government is negotiating with the World Trade Organisation (WTO) to be a full member. Chapter Two discussed that the Saudi private sector faces the challenges of international trade liberalisation and globalisation. When the Kingdom becomes a member of the WTO, it will open fully its markets to international investors and Saudi firms will find new opportunities to invest in other markets. Furthermore, the Kingdom is now entering a new phase of development by shifting from a public sector driven economy to one in which the private sector has become the engine for growth. Saudi Arabia has already accelerated privatisation in

various key sectors. This privatisation process is expected to enhance the private sector's economic activity and increase the available opportunities for private investment. This new situation requires Saudi firms to be large enough, to be able to compete with other local and international firms, and to have the appropriate funding to finance current and future projects.

The final justification for this result concerns religious belief. All Saudis are Muslims and most obey the roles and principles of Islam. Islam prohibits its followers from dealing with usury, "*riba*", additional money charged for use of money borrowed. Therefore, firms may prefer to raise money from the stock market rather than borrowing the necessary funding from financial institutions, which will impose interest on the money lent.

It can be said that the second motivation for going public, "companies want to be competitive", is consistent with the first motivation. Edward McVaney, chief operating officer of J. D. Edwards, commented that his (September 1997) IPO had led more corporate customers to start thinking of his company as a valid ERP (enterprise resource planning) competitor. *"Privately held companies get no respect,"* he stated (Brown, 1997, p. 244).

Chapter 2 showed that competition in the Kingdom is fierce for many reasons, such as cheap labour, a free tax rate, and an open market policy. Being a JSC would enable firms to be more competitive for various reasons. Firstly, the public would feel more loyal to the company since many of them would own some shares in the firm. The visibility and

reputation public companies gain can help them win more customers. For example, Mr. Al-Rajhi said in his interview that:

> *"Because our business is banking, public trust is essential. We want the public to feel that the bank is their bank. Listing the bank on the stock market helps us to reach this goal".*

Moreover, Chapter Five presented that, by being listed in the stock market, a company's name would be more recognisable and better known (Ransley, 1984). The reputation and visibility they gain as public companies can help them to win customers, secure financing, or expand from a regional company to a national one (Hare, 1994). In other words, listing on the stock market from an IPO works as an advertising tool for the company. Secondly, there are many well-qualified Saudi personnel willing to work in JSCs. Saudis in general like to work in companies controlled and monitored by known rules and regulations, and to have something of a secure future. JSCs companies can provide this environment for them. This fact was supported by most of the interviewees. The interviewees noticed that when they went public, better skilled personnel were willing now to work with them. Dr. Al-Zamil said that they were able to attract very good staff after the IPO. He said:

> *"We cannot do this if the company is not joint stock, because these people do not want to always work in a company controlled and owned by one person and be at his or her mercy".*

The third, fourth, and fifth motivations for going public are personal motives. It is well-known that one of the advantages of going public is the original owners have the flexibility to diversify and liquidate their investments easily by trading in the stock market (Rydqvist and Högholm, 1995, and Pagano *et al.*, 1998). In general, investors look for a less risky and more profitable portfolio, which can be achieved by diversification. Therefore, it is natural that investors in Saudi Arabia seek to strengthen their financial position by owning diversified portfolios and benefit from one of the advantages of going public (third motivation). This results also supported by the interviewees. For instance, Dr. Al-Zamil said that the second motivation for them to go public was to liquidate part of their investment. He added that the family sold 40% of their company and used the money to create other companies in the petrochemical and other sectors in Saudi Arabia.

Moreover, Chapter Two showed that, in Saudi Arabia, family businesses are the majority and, culturally, these families control and manage their businesses. Chapter Two also discussed that the Saudi family businesses face the problem of generation shift. Going public would give them the ability, to some extent, still control their businesses, keep their name, diversify or liquidate their investments easily, and get the necessary funds to finance their future growth (fourth motivation). In addition, many Saudi family-owned firms are now facing a generational shift and need to take legal steps to ensure continued business activity (Ministry of Planning, 2003). Chapter Two also reviewed that one of the most important problems facing family businesses is the ability to survive. Studies show that the average age of the family business is 24 years, with one third of family businesses continuing after the first generation, but only 10% of family businesses still

extant after the second generation. One of the possible solutions for keeping these firms alive is switching to becoming joint stock companies, which might solve the problem of a lack of family succession and keeping the business running (fifth motivation).

Contrastingly, participants do not think companies go public because the government has eased the procedures for doing so. This is not a surprising result, since it is known that the Saudi government has strict requirements for firms wishing to seek public equity (Butler and Malaikah, 1992). As discussed in Chapter Four, dealing with the procedures for going public in Saudi Arabia, firms wanting to make an IPO have to go through restrictive regulations and the procedure could take a few years. These restrictive regulations as well as the time needed to finish them contribute to discouraging original owners from transferring their firms. This barrier was mentioned by some interviewees as well. They claimed that the procedure for going public in the Kingdom was long.

In addition, it seems that companies do not go public to enhance employee status. One likely justification for this result is that in Saudi Arabia regulations relating to employee status are the same regardless of the legal status of the firm. Therefore, companies after the IPO may have the same policy toward employees as before. Another possible explanation is that going public to enhance employee status is a managerial motivation. Since the majority of firms in Saudi Arabia are family businesses, the possibility that going public will be used for managerial motivation is very low, and owners look after their own interests.

9.3 Barriers to going public in Saudi Arabia

It can be concluded that market and personal factors are the most important barriers affecting negatively the rate of going public. The questionnaire shows that "the failure of many joint stock companies listed in the SSM to generate profits" is ranked as the most important barrier in Saudi Arabia, and "owners avoid going public because of the possible loss of control" ranked the second highest barrier. The third highest barrier is "fear of more restrictions on private transactions". The "stock market is not open completely for international investors" is ranked the fourth highest constraint reducing the rate of IPOs, and "unwelcome attention regarding a possible takeover" is ranked the fifth highest barrier. However, most of the interviewees thought that the long procedure plays the most important role in reducing the rate of IPOs.

The fact is that "failure of many Joint Stock Companies listed in the SSM to generate profits and to be successful" has contributed the most to reducing the rate of IPOs and making the decision makers in private companies reluctant to make an IPO. Unfortunately, as has been discussed in Chapter 3, the development of the Saudi Stock Market, many public companies in the 1990s, 2000, and 2001, except those in the banking and cement sectors, have continuous negative or low performance. This fact makes private firms think that the legal status of a joint stock company could be unsuitable and affect negatively their performance. Therefore, trust in JSCs is low in the Kingdom and the evidence of this low trust is the number of JSCs in the country. There are just 116 JSCs, making up 1.14% of the total companies operating in Saudi Arabia.

The second and fifth highest barriers to going public are somewhat related to each other. The second highest barrier is the concern of original owners at losing control of the companies and the fifth is unwelcome attention regarding a possible takeover. As discussed in Chapter 5, the literature review, loss of control and possible takeover, among other reasons, were considered to be the most important disadvantages of going public (Zingales, 1995; Brennan and Franks, 1997; and Pagano *et al.*, 1998). As new shareholders are added, the initial owners' power to control the company is diluted.

The regulations in Saudi Arabia require firms wanting to go public to offer more than 40% of the shares (Article 52). Generally speaking, if owners sell just 40% of the total shares, they would not lose control, but as has been shown, participants think going public gives owners the ability to cash in their investments easily. Therefore, the more shares the original owners sell, the less control they have. The interviewees did not have any concerns about losing control and so were able to overcome this barrier. Most of them said that they still held most of the shares, and therefore still controlled the company. For example, Dr. Al-Zamil said they had sold 40% of the shares at the IPO, but they still held 60% of the shares, enabling them up to now to control the company.

The third highest supported barrier was the fear of more restrictions on private transactions. The owners of a private firm can use the firm's resources for their own purposes such as employing their relatives at favourable conditions (Rydqvist and Högholm, 1995).

There is no doubt that private firms in Saudi Arabia do have more flexibility in dealing with company resources. The regulations do not prevent owners from using the cash

which is available to the firm for activities other than the main activity of the firm. However, JSCs have no flexibility in using the cash in activities different from the stated activities of the company. Dr Al-Zamil gave a good example explaining the situation. An example he gave:

> "*A piece of land is under offer at a really good price, and if you buy it and keep it even for a short time, you can sell it at a very good profit. However, you cannot buy it because trading in properties is not the purpose of the company. Missing such good opportunities is a very high price paid by owners*".

The fourth highest barrier is that the stock market is not open completely to international investors. As discussed in Chapter Three, although the Saudi government has adopted an open market policy and international investors are welcome to invest in the country, the government has not allowed foreign investors to enter the SSM freely. The Saudi government is reluctant to open the stock market to foreigners because of the fear that foreign investors would hold most of the shares and the market would come under their control, at their "mercy". Because of this ban, the stock market has lost a lot of cash that would flow into it. It was shown in Chapter Three that stock market liberalisation would increase the quality, pricing, availability of products and services, and the buying power and demand for the stocks. However, in 1999 the government started to allow non-Saudi citizens to invest in the SSM through special funds established and controlled by local commercial banks.

It is surprising that this regulation of the SSM did not figure more highly. By effectively restricting the demand for securities, the potential for a successful IPO is largely

eliminated. It is clear that the restriction is unnecessary since the original owners were primarily interested in control.

On the other side of the equation, participants do not support some factors and thought these possible barriers did not affect the rate of going public. Participants did not consider the income tax rate as a barrier to going public in the country. This result is consistent with the fact that Saudis do not pay tax. As discussed in Chapter Four, income tax is only imposed on foreign investors. Therefore, income tax plays no role in reducing the rate of going public.

Moreover, participants did not believe that "the lack of well experienced personnel who can manage companies after transition" affected negatively the rate of going public in the Kingdom. Frankly, as been shown in Chapter Two, Saudi Arabia has given a great deal of attention to developing its human resources in the last decades. For example, enrolment in all educational institutions increased from around 600,000 in 1969 to about 4,748,000 students (male and female) in 1999 (Ministry of Planning, 2002). Moreover, from the 1970s to 2002, more than 300,000 people gained higher degrees from respected universities and other institutions, particularly in the UK and USA.

9.4 The performance of IPOs after the transition

Interestingly, most participants in the questionnaire believed that the performance of the IPOs would decrease after the transition. Nevertheless, most of the interviewees thought that the performance of the IPOs would increase after the transition or stay at the same level. The likely explanation of this contradiction is that many of the participants have

not experienced and lived with the decision of going public. Another possible explanation is that the interviewees talked about specific cases, their companies, but the participants in the questionnaire talked about the performance of IPOs after the transition in general.

The results from the questionnaire regarding the performance of the IPOs are consistent with most of the existing literature. For example, Degeorge *et al.* (1993), Jain & Kini (1994), Cai & Wei (1997), Mikkelson *et al.* (1997), Pagano *et al.* (1998), Kutsuna *et al.* (2002), and Kim *et al.* (2004) investigated this matter and found that IPO performance decreases in the years following the decision to go public. Furthermore, the questionnaire results are also confirmed by the results obtained from the actual investigation made in this study on the Saudi IPO (the single case study). The financial ratio analysis in Chapter Seven demonstrated that most of the profitability ratios declined after the IPO.

However, the results from the interviews are also supported by only the study of Holthausen and Larcker (1996) who found that the performance of the IPOs improved.

The participants in the questionnaire and the interviewees gave likely explanations and reasons which may have a positive effect on the performance of IPOs after the transition. Real reasons found by the interviewees were that after the transition their companies were able to:

- Attract people with good experience to help them manage the company
- Improve their credit rating
- Gain more trust from customers
- Grow more

- Be more competitive
- Use the new position as an advertising tool
- Diversify their businesses

Moreover, the participants who believed the performance of the IPOs would improve after the transition listed some possible reasons for that. The first agreed reason was that after the transition, management and employees became shareholders, giving them more incentive to work harder. This is true since employee and management stock ownership can be a very dynamic tool for improving employee productivity and thereby increasing the profitability and value of the company. It has been seen from the case study, in Chapter Seven, that the IPO management used this strategy when it sold 30,000 shares to the employees of the company. Interestingly, this result is not consistent with the results obtained from the motivations. It has been shown that decision makers in the Kingdom are not motivated to go public to enhance employee status.

The second and third highest reasons for improving IPO performance are related. The second reason is that after transition, IPOs hire professional personnel to lead the company and the third reason is the change in ownership structure after transition. This result is strongly supported by Dr. Al-Zamil. According to Dr. Al-Zamil, the third advantage was that because the company is now joint stock, they were able to attract very good staff. He said: "*we cannot do this if the company is not joint stock, because these people do not want to always work in a company controlled and owned by one person and be at his or her mercy*". Moreover, Dr. Al-Zamil also said, "*the fourth motivation,*

which we talked about for a long time, was to move our management from being non-professional to very professional. We are trying to split ownership from management".

However, these results of the second and third highest reasons for improving IPO performance are contradicted by the fact that, as discussed previously, it is common in Saudi Arabia for private firms and IPOs to be managed by their original owners. After the IPO, the ownership structure could change a little and the original owners still have full control of the company. Some of the interviewees, such as Al-Zamil and Al-Rajhi, emphasised the fact that they are still controlling and managing their companies after the IPO. For example, Al-Zamil family still hold 60% of the shares. There are still seven of the eleven original owners from the Al-Zamil family on the board of directors, and Dr. Al-Zamil still is the chairman.

The fourth reason is that IPOs grow more, the fifth is that IPOs diversify their business. The sixth reason is that IPOs' products and names get more publicity, and the seventh is the interest rates that IPOs are charged decrease. These results are consistent with the findings in the motivation section and with the findings obtained from interviewees.

However, on the other hand, respondents, who believed that the performance of IPOs would decline after the transition listed some possible justifications for that. The first justification was that the controlling shareholders and top managers might give themselves more privileges (increased salaries, bonuses, etc). This finding is consistent with the fact that the Saudi Companies Act gives the board of directors the right to specify the manner of remunerating directors and such remuneration may consist of a specified salary, an attendance fee for the meetings, material benefits, a certain

percentage of the profits, or a combination of two or more of these benefits (Article 74). The financial statements of the case study show that the directors' remuneration and compensation two years before the IPO was SR 2,968,000 and SR 4,965,000 two years after the IPO.

Therefore, participants have a perception that IPO's board of directors would abuse this right and issue decisions serving their own interests, such as increasing their salaries and bonuses. However, it should be said here that this justification is not really about performance. It is more about directors' misbehaviour. In other words, the company could perform well but the directors and top management would benefit most from this success.

The second explanation for this decline is that the original owners time their IPO to coincide with a period of better performance. This justification is supported by the literature review. Empirical studies have shown that companies can coordinate their IPO with high performance (Degeorge and Zeckhauser, 1993). However, this would not be the case in Saudi Arabia, since the procedure for going public would take a few years (see the discussion of the barriers to going public in the Kingdom, and also Chapter Four).

9.5 The effect of an increase in the number of joint stock companies on the Saudi economy

The study finds that business people in the Kingdom expect that an increase in the number of IPOs would improve economic growth, the balance of trade, the

unemployment rate, and international investment. Also, business people think that IPOs would strengthen companies' positions by making them more competitive and diversified. Furthermore, the study suggests that an increase number of IPOs would not have an effect on either the inflation rate or on interest rates. One of the interviewees, in the single case study, said:

> *"JSCs are created by large number of investors and become large companies with a large capital base. These companies can work in businesses which are sometimes difficult for individual investors to work in, such as communications or energy. Therefore, every country needs these kinds of companies to help the government to provide some necessary services. In addition, these kinds of companies can help also the government to provide jobs for the people".*

Moreover Dr. Al-Zamil said:

> *"One of the weakest points in our economy is that there are not a large number of joint stock companies. 93% of all shares on the Saudi Stock Market are owned by the government, large financial institutions, and some wealthy families, and only 7% of the shares are traded in the market. Because of this, the market cannot attract new investors. This is ridiculous. We have to encourage more companies to go public. The Saudi Stock Market can have at least 1,000 joint stock companies. Now, we just have 71. This is silly"*

Firstly, the participants believed that an increase number of IPOs would improve the growth rate. As discussed in the section on the motivations for going public, private firms

are motivated to use the money raised for more growth and expansion. An increase in companies' size and businesses would improve growth, competition, and the unemployment rate. The literature review showed that the stock market is a key player in promoting economic growth. Rousseau and Wachtel (2000) say that the stock market can stimulate economic performance by:

> *"(1) providing an exit mechanism to venture capitalists, (2) offering liquidity to investors that encourages international diversification and portfolio flows, (3) providing firms with access to permanent capital which can then be placed in large, indivisible projects, and (4) generating information about the quality of potential investments."*

Furthermore, the idea that an increased number of joint stock companies would have a positive effect on the Saudi economy is strongly supported by the interviewees. Dr. Al-Zamil gave a great example of the relationship between the number of JSCs and the economy. He said that they sold 40% of their company and used the money to create the International Petrochemical Company as a joint stock company and it employs hundreds of people and helped also to attract international investors.

In addition, Chapter Two shows that many firms in the Kingdom are struggling to make enough profit due to the difficulties in controlling costs, an *inability to provide* the right goods and services to customers, and severe market competition. The negative impacts on corporate profitability ultimately limit a nation's long-term growth prospects and standard of living. Moreover, most firms in the Kingdom are family businesses and studies show that only 1 in 10 family businesses survive until the third generation.

Therefore, firms should restructure themselves, leading to reducing cost inefficiencies and improving productivity, hence paving the way for a stronger expansion from a business investment, which consequently would improve economic performance.

Moreover, the participants and most of the interviewees believe an increase in joint stock companies would attract international investment. Chapter Two revealed that the Kingdom is making huge efforts to attract the international investors. It could be argued that the idea of an increase in joint stock companies would attract international investment is correct, since foreign investors look at many variables before investing in a country. The size and performance of the stock market are one of these important variables. The stock market may be an indication of the strength of a country's economy. Therefore, the more good companies listed on the Saudi Stock Market, the more trust international investors will have in the Saudi economy.

In addition, foreign investors look for good accounting information and a good corporate governance structure. The efficiency of such a market, as of any other stock market, depends on the availability of information to all investors at low transaction costs. Information, especially about a company's performance, should be available to all interested parties, so that they can behave in a way which makes security prices continually adjust to any new information. In this respect, the disclosure of accounting information has a great impact on the behaviour of investors with respect to buying and selling of stocks in the capital and financial market. In addition, it is strongly believed that reliable and timely accounting information has a significant role in facilitating, controlling, and directing both private and public activities. Before 1986, the Company

Law, Accountants' Law, and Income Tax and Zakat Law were the basic regulations guiding the accounting and auditing professions. The Company Law *requires all* corporations to disclose important information to users at the end of each fiscal year. The documents required are a balance sheet, a profit and loss account, a summary of the directors' report, and an auditors' report (Article 89). Moreover, the Ministry of Commerce determines the objectives and concepts of financial accounting. Based on these objectives and concepts, a General Presentation and Disclosure Standard (GPDS) was prepared. In 1990, the Ministry of Commerce issued a decree obliging all companies to comply with this standard when preparing their annual reports.

It should be known that foreign direct investment would bring advanced technology into the country and play a vital role in expanding the scope of local competition, therefore, leading to increased productivity and efficiency. To attract foreign investment, the Saudi government should also continue its efforts to improve the general environment for private sector activities, improving and expanding infrastructure services and developing new regulations for investment, business, markets, and economic activity in general.

Respondents also believed that more IPOs would improve the balance of trade. As has been shown in Chapter Two, the Saudi trade balance depends entirely on its oil and petrochemical products, which are responsible for more than the two third of the Kingdom's total exports. For example, Saudi Arabia recorded a trade shortage of $12 billion in 1998 after a surplus amounting to $100 million in 1997 and $200 million in 1996 due to increases in petroleum prices.

There is support for the idea that going public would make companies more competitive locally and internationally, and improve their size and their abilities to diversify their products and services. They would, therefore, be capable of increasing their exports and also providing the necessary goods and services for local customers, which would also decrease imports.

Finally, it should be mentioned here that the performance of the macroeconomic factors and the general economic situation could also have a great effect on the demand of the IPOs. To illustrate this point, the growth and profitability of the Saudi IPO under investigation, the single case study, were negatively affected by the economic slowdown in the period post the IPO.

9.6 The characteristics of companies going public in Saudi Arabia

The findings in the questionnaire reported that "companies owned by more than one investor" are the most likely to go public in Saudi Arabia. "Large companies (in terms of size)" came second, "high growth companies" third, "companies working in very competitive industries" came fourth, "well-known companies" fifth, and "manufacturing companies" sixth. "Profitable companies" ranked *seventh*, "*overvalued companies*" eighth, and finally, the ninth, tenth, and eleventh ranked types of companies were "old companies (in terms of age)," "very risky companies," and "companies having a huge amount of debt" respectively. The interviewees thought companies working in the industrial sector are most likely to go public. Finally the Saudi IPO under investigation in

this study was owned by more than one investor, large in term of size and employees, working in very competitive market, and had a considerable amount of debt[38].

One of the possible justifications for the result that companies owned by more than one investor are more likely to make IPOs is that the legal form of the JSC has some advantages which other legal forms do not. One of these important advantages is that this legal status gives the company its own personality and separates it from its owners. It has been seen from the questionnaire and interviews that companies are motivated to go public to separate the life of the company from the life of the owners. Moreover, original owners take their companies public to overcome the conflicts, which increase if there is more than one investor, accruing between owners about the leadership of the company. Dr. Al-Zamil raised this issue when he said that any owner of a private company can freeze the business at any time. However, if the company is joint stock, no one can stop the business. Therefore, after the IPO no owner can stop the business and if any shareholder has complaints or doubts, they can sell their stock or start a campaign to collect votes to change the management, but they cannot freeze the business.

Another justification for this result is that if any owner wants to sell a share in the company, they have to agree first on the real market value of the company. Going public establishes a value for the firm more easily, since the stock price is a signal of the most likely value of the firm (Rydqvist and Högholm, 1995, and Brigham and Gapenshi, 1997). Therefore, after a listing on the stock market, owners would be able to determine the real market value of their share and they can sell it at any time.

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[38] Its capital at the time of the IPO was SR 270 million, the number of the employees was 725, and its total debt ratio was 63.8%. For more information about the company, please see Chapter Seven.

According to the questionnaire, large companies, in term of size, came second as companies that are more likely to go public. This result is supported by many studies in the literature (see for example, Matsuda *et al.*, 1994, Rydqvist and Högholm, 1995; Cai and Wei, 1997; Torres, 1997; and Kim *et al.*, 2004). In terms of Saudi Arabia, one possible explanation for this finding is that the Saudi Companies Act requires firms which want to go public to have assets worth SR 50 million (£ 9 million) or more and be making satisfactory profits (Ministry of Commerce, 2002).

Another likely justification is that the public, in general, has more trust for larger companies than small ones. This trust comes from the fact that large companies usually have visible assets, and large numbers of employees. Furthermore, they are usually well established, well organised, and competitive. This trust is important in making the IPO successful. One more explanation is that going public, as has been discussed in chapter Five, implies considerable direct costs, such as registration fees, auditing, visible studies, and underwriting fees. Most of these expenses are fixed and, therefore, do not increase proportionally with the size of the IPO. So, they weigh relatively more on smaller companies and less on larger companies.

In addition, the findings from the questionnaire reveal that high growth companies are the third kind of companies that are more likely to go public. One likely explanation of this result is that such companies need funds to finance their current and future projects. The stock market can be a good financial source, providing the necessary funds. Moreover, the questionnaire and interviews reveal that companies do go public to use the money raised for more expansion and growth.

Interestingly, most of the interviewees ranked manufacturing companies as the most likely to go public, but questionnaire participants ranked manufacturing companies as the sixth most likely to go public. For example, one interviewee said that companies working in the industrial sector are capable of going public because they are trusted by the people and the legislators. In addition, Dr. Al-Zamil said that manufacturing companies were more acceptable by the public since they have visible assets. The interviewee's claim might be supported by the fact that most of the companies that went public in Saudi Arabia in recent years are manufacturing firms. Table 3-1, in Chapter Three, shows that five out of ten companies that raised public funds were manufacturing companies.

The differences between the interviewees' and questionnaire participants' opinions come from the background of these two groups. Table 8-6 in Chapter Eight shows that the highest number of questionnaire respondents came from firms working in more than one sector (35.2%), then both the trading and the manufacturing sectors (18.6%), followed by the service sector (12.4%). However, four out of five interviewees came from firms working in the industrial sector, it is natural that they would favour manufacturing firms.

9.7 Suggestions to improve the rate of going public in Saudi Arabia

The questionnaire participants supported most of the suggestions stated in the questionnaire. They ranked the suggestion that "the Saudi government should create a complete financial system" as first and "the Saudi government should prepare a clear guideline that explains the procedures for going public" as second. The third ranked was "the decision makers in the private firms should separate management from ownership and hire professional personnel to lead the companies", and "the Saudi government

should ease the regulations for firms willing to go public" and "the decision makers in the private firms should reshape companies' organisational structure" as fourth and fifth. The interviewees also supported some of the last suggestions, such as "the Saudi government should create a complete financial system" and "the Saudi government should ease the regulations for firms willing to go public". The interviewees listed yet others, like support industrial investment and export funds, go public gradually, and privatise some governmental companies.

It is obvious from the suggestions that the participants are asking legislators to do more to increase the rate of going public. For example, the highest level of agreement between the questionnaire respondents and the interviewees came from the suggestion that "the Saudi government should create a complete financial system". Despite its stock market being the biggest in the Middle East, Saudi Arabia does not have a complete financial system. But, the government is preparing this complete system which will cover all matters related to issuing stocks and bonds by corporations, establishing stock exchanges working alongside the Electronic Securities Information System (ESIS) which is used now, and establishing an independent monitoring agency.

Saudi Officials and business people hope this step, when it comes to fruition, will encourage private firms to think more about financing their businesses from the stock market, since it will create a developed financial environment, regulate all the issues related to the financial market, ease the requirements for going public, and attract new investors.

The second most supported suggestion was "the Saudi government should prepare a clear guideline explaining the procedures for going public". As noted previously, some participants and interviewees see the long procedure as a major obstacle and also it has been shown in Chapter Four, dealing with the procedure for going public, that companies willing to go public have to go through a lengthy procedure and have to fulfil a list of requirements in order to get permission to make an IPO. This guideline could clear any misunderstanding and make it easier for firms to complete the procedures.

The third most supported suggestion was "the decision makers in private firms should separate management from ownership and hire professional personnel to lead the companies". Once a company becomes professionally managed, the public and the government officials would have more confidence in it, therefore, it will be somewhat easier to get permission to make the IPO and be successful.

9.8 Summary

This chapter is divided into six sections. The first section discussed the motivations for going public. The second section presented the barriers to going public in the Kingdom. The third section dealt with the performance of IPOs. The fourth section discussed the effect of an increase number of IPOs on the Saudi economy. The fifth section dealt with the characteristics of IPOs, and the sixth sections presented suggestions for increasing the number of IPOs in the country. This chapter has attempted to make a link between:

- the findings obtained from the single case study, the questionnaire, and the interviews,

- the findings of previous studies conducted in other countries,
- the Saudi business and cultural environment,
- Saudi Arabia IPO evidence.

Finally, it can be seen that many of the findings of this study support the findings of other studies. Nevertheless, in some cases, the unique Saudi situation plays an important role in the outcome of the thesis findings.

10.1 Introduction

The literature review shows that most of the studies related to IPO issues have been conducted in developed countries such as the United Kingdom, Sweden, Japan, and the United States. Unfortunately, the researcher could not find any research covering IPO issues conducted in developing countries, except one conducted by Kim *et al.* (2004). This study tries to narrow the gap by studying the motivation for going public, the barriers to going public, the performance and characteristics of IPOs, and the effect of an increase in the number of IPOs on the economy of Saudi Arabia. Moreover, this thesis raised a fundamental question that can the going public decision contribute to solve the problems of the Saudi private sector?

This chapter summarises research project, research methodology, answers to the thesis questions, implications, limitations, and suggestions for further research.

10.2 Research project

The researcher believes that it was important to discuss the Saudi economy, the SSM, and the procedures for going public and their possible impacts on the IPO activities in the Kingdom before undertaking an empirical investigation. These subjects were examined in three chapters. Chapter Two was designed to shed further light on the economic development, the contribution of the Saudi Arabian government to the economy, the influence of the private sector on the economy, and competition in the Kingdom. The

economic history of Saudi Arabia, and the macroeconomic factors were presented. New regulations and reform programmes that could strengthen the private sector and the SSM and the five year development plans in term of direction, achievements, and priorities of expenditure on development were reviewed. The development of the private sector, and the challenges facing the private sector were also discussed. In addition, the classification of the companies operating the Kingdom was presented. Competition in the country was assessed using Porter's five forces model.

Chapter Three presented the history of the SSM. The important roles of the Saudi Arabian Monetary Agency (SAMA), and the development of the SSM in terms of primary and secondary markets were discussed. This chapter also presented the share negotiation system, the electronic securities information system, and the calculation of the SSM price index and stock market sectors. The percentage changes in the price indexes for each sector were analysed to assess the performance of these sectors. Finally, the participants in the SSM, the characteristics of the SSM, and its efficiency were also discussed.

Chapter Four presented and discussed the procedures for going public in Saudi Arabia. The Companies Act was the first body of regulations to set out rules for the general requirements for going public, accounting and auditing in the Kingdom, and the requirements that companies have to meet to convert to joint stock status. Moreover, this chapter dealt with the general regulations of corporations after they go public, dealing with companies' stock, company accounts, the auditors, and increases and decreases in capital.

A review of the literature related to IPO issues was made in Chapter Five. The pros and cons of going public, the performance and characteristics of the IPOs, and the relationship between the economy and IPOs were discussed.

At last, the review of all the previous subjects is believed to be an important step in providing a suitable framework for the empirical investigation. This extensive review assisted the researcher in this study to choose the most appropriate data collection instruments and data analysis techniques, and to discuss the final results.

10.3 Research methodology

This study adopted both quantitative and qualitative approaches for achieving the study goals. This was achieved by distributing the questionnaire directly and asking the top management for their perspective on several IPO issues, making a single case study of a Saudi IPO, and interviewing three owners and CEOs of Saudi IPOs.

Firstly, a mailed questionnaire was used in this study since it has considerable advantages over personal and telephone surveys. The top 500 Saudi companies, in terms of sales, were selected for the sample. The reason for this selection was because the managers of those companies are more capable of providing valid information since they are usually well educated and experienced. A 5-point Likert Scale was used for most of the major questions in the questionnaire, creating multiple-item indicators. In this study, for the answers a t-test used to ascertain if there were significant differences between two independent variables and analysis of variances (ANOVA) was used to find if there were significant differences between more than two independent variables. This study also

used chi-square test to find if there were significant differences between independent variables in case of categorical scale. In addition, the means, standard deviations, coefficients of variation, and frequencies were calculated helping to rank respondents' average responses to a problem or an issue in order.

Secondly, a case study was made of a company that went public in Saudi Arabia. Financial ratio analysis and interviews with the senior managers of the company were used in this case study. Thirdly, three executives, who took their firms public and have rich information on the matter, were interviewed by the researcher.

10.4 Results

The main findings, which were presented in Chapter Seven and Eight and discussed in Chapter Nine, were:

1. Like most of the existing literature, this study found that private firms are motivated to go public for strategic and personal reasons. Decision makers are motivated to go public to use the money raised for more expansion and growth; to be more competitive; to diversify part of their investment; and to solve the problem of lack of family succession and control.
2. This study found that the Saudi business environment played the most important role in reducing the rate of IPOs in the Kingdom. Private firms in the country are reluctant to go public because of the failure of many joint stock companies listed on the Saudi Stock Market to generate profit, the possible loss of control, fear of

more restrictions on private transactions, and because the stock market is not open completely for international investors

3. The study discovered that 42.7% of the questionnaire participants, the majority, believed that IPO performance would decline after the transition. Their belief also was supported by the investigation of the Saudi IPO (the single case study). The financial ratio analysis showed that despite the status of being a JSC made the company more competitive, management more effective, and improved the credit rating, the profitability was better in the pre-IPO period. However, most of the interviewees claimed that the performance of their companies improved after the transition.
4. Interviewees believed that the IPO gave them several advantages, especially liquidating easily part of their investments, and improving their credit rating. However, interviewees thought that the IPO had some disadvantages, particularly disclosure requirements and more restrictions on private transactions.
5. Most of interviewees said that the ownership structure did not change greatly after the IPOs and they still control their companies. They did not believe that the IPO decision had any effect on the competition. Furthermore, interviewees said that they diversified their businesses after the IPO.
6. Interviewees also claimed that the growth of companies was positively affected by an IPO. However, the single case study investigation showed that the Saudi IPO grew less in the post IPO period.
7. The study found that the main reasons for IPO performance increases were that management and employees became shareholders, giving them more incentive to

work harder; IPOs attract well-qualified personnel; and IPOs grow more and diversify their businesses.

8. The major reasons for a decline in IPO performance were that the controlling shareholders and top managers give themselves more privileges (increase their salaries, bonuses. etc), and the original owners time their IPO to coincide with good performance.
9. The study found that an increase in joint stock companies in the Kingdom would improve several economic factors, especially the growth rate, foreign investment, the balance of trade, and the unemployment rate.
10. The current research found that companies owned by more than one investor, large companies (in terms of size), and companies working in the industrial sector are more likely to go public.
11. This research suggests that if the Saudi Government creates a complete financial system and prepares clear guidelines that explain the procedures for going public that would help to increase the rate of going public in Saudi Arabia. Moreover, this study also suggests that the decision makers in private firms can help to improve the rate of IPOs by separating management from ownership and hiring professional personnel to lead the companies.

10.5 Implications

The study provides some implications for companies working in Saudi Arabia, the public, and the government.

10.5.1 Implications for companies and the public

Since the private sector in Saudi Arabia has little experience of IPOs, because this phenomenon has occurred relatively few times, the decision makers in firms considering the IPO option, could use this study as a reference, which could enhance their decisions. The decision makers can now gain some idea of the circumstances of an IPO, since the study explains the benefits and disadvantages of going public, and the possible effect of this decision on the profitability, ownership structure, diversification, and competition. Some implications can be concluded from the study:

- An IPO is an option for raising new funds for the firm and original owners. This money can be used in many rational ways, such as financing new or current projects, paying the debt, and diversifying original owners' portfolios.
- If the flotation decision is used legitimately, it would solve many problems that Saudi private sector has. This decision would help to improve a firm's performance, since the position of being a JSC would make the firm more competitive, decrease borrowing costs, increase public trust, and help it enter new markets and businesses. Moreover, this decision would separate the life of the company from that of the original owners, therefore, solving the generation shift problem.
- Although the decision to go public can solve many problems, it can also create new problems. For example, IPOs should disclose all necessary information frequently to the public, but full disclosure can create a fear of possible takeover.

- The decision makers should know that not every IPO case is the same. They should evaluate each case according to its situation.

Private firms operating in the Kingdom, willing to make an IPO, can adopt some suggestions which might help them in going public. Decision makers in private firms can improve their position when going public by:

- Separating management from ownership and hiring professional personnel to lead the company
- Reshaping the company's organisational structure
- Disclosing more information about the company's activities and financial status to the public
- Enrolling in training programmes to increase their knowledge of IPO issues.

Finally, the public, especially investors in the stock market, always wonder about the real motivations behind IPOs and also the real reasons behind the low number of JSCs in the country. This study also gives some answers to these questions.

10.5.2 Implications for government

The government, at the present time, is encouraging firms to go public. This study provides government officials with some essential information and a general direction and suggestions which could help to reach this goal.

Firstly, the study gives officials some clues about the barriers preventing firms from making IPOs in Saudi Arabia, and the motivations encouraging them to go public.

Secondly, the study advises the government to adopt some steps which could increase the rate of going public. For example, the Saudi government can encourage firms to go public by:

- Creating a complete financial system
- Preparing clear guidelines that explain the procedures for going public
- Easing the regulations for firms willing to go public
- Allowing non-Saudi investors to participate freely in the SSM
- Easing the regulations for firms and persons willing to be underwriters

It should be said here that the study does not suggest that the government allows banks to invest in the SSM, grant IPOs more subsidies, or allow foreign companies to be listed on the SSM.

Thirdly, the study provides important information about the companies that are more likely to go public and make successful IPOs. The government could now focus on these kinds of firms and adopt regulations which would encourage them to seek public equity.

Finally, governmental officials and planners also now have an idea of the potential effect of an increased number of IPOs on the Saudi economy. The study suggests that the development of the stock market and an increase in companies listed on it would improve economic performance. It would have a positive impact on economic growth, the unemployment rate, international investment, and the balance of trade.

10.6 Contributions

The current study attempted to contribute to the current research on IPOs in three ways. Firstly, the current study contributed to the literature of finance in two ways. One, it confirmed some of the existing findings. For instance, this research confirms the finding of Ransley (1984), Jain and Kini (1994), McConaughy *et al.* (1995), Rydqvist and Högholm (1995), Holthausen and Larcker (1996), Mikkelson *et al.* (1997), Kutsuna et al. (2002), and Kim *et al.* (2004) who believed that companies go public to use the money raised for more growth and expansion. This study also confirm that the findings of Rydqvist and Högholm (1995), Zingales (1995), Brennan and Franks (1997), Cai and Wei (1997) Mikkelson *et al.* (1997), and Pagano *et al.* (1998) who found that one of the major disadvantages of going public is the loss of control. Two, it discovers new findings and results. For example, the study discovered that the most important barrier preventing firms in Saudi Arabia to go public is the failure of the Saudi JSCs to generate profit. Moreover, the current research found that companies owned by more than one investor are more likely to go public.

Secondly, as noted in the methodology chapter, the use of three research methods (a single case study, questionnaire survey, and interviews) in a complementary way provided a clearer picture of the current IPO issues in Saudi Arabia. The analyses of the single case study, questionnaire, and interview data complemented each other as follows:

1. The single case study allowed the researcher to investigate the real effect of the going public decision on the company's financial indicators, such as the profitability, capital structure, and turnover.

2. The questionnaire enabled the researcher to review the opinions and attitudes of the managers of the top 500 companies, operating in the Kingdom, towards the IPO issues.
3. The interview data was used in the current study to complement the analysis of the questionnaire and the case study. The interviews were structured to look for consistency in results – i.e. were the 'fact' the same – and as an explanation of the evidence collected elsewhere.

Thirdly, the current study is also innovative in terms of its subjects. To the best of the researcher's knowledge, there is no previous empirical study on the IPOs in Saudi Arabia. Therefore, the researcher hopes the current study would encourage more researchers to investigate, theoretically and empirically, the IPO activities in the Kingdom.

10.7 Limitations

The findings and results of the study revealed that there are some limitations that should be noted. These limitations are as follows:

1. The study has only one single case study. A huge effort was made to have more cases, but the companies which made IPOs were not willing to provide the necessary information.
2. Another possible limitation relates to the response rate to the questionnaire that was sent out. The response rate was only 29%. This low response rate raises a

concern as to the reliability of the results. However, the non-response bias test showed that the non-response bias does not seem to be an important issue.

3. Although the total sample of 145 participants is a reasonable size for analysis, the relatively small number of respondents who had experience of an IPO places a limitation on the external validity of the results.
4. A further limitation is associated with the fact that the questionnaire in this study measured current management views and perceptions on several IPO issues. Thus, it measured predictions, not hard facts. Nevertheless, the findings and results should not be underestimated, since managers' intuition is considered a valid source of information.
5. Finally, the findings and results of the study are limited only to Saudi Arabia. Since Saudi Arabia has its own unique culture, business environment, institutions, and position, the findings of the study cannot be generalised to other countries.

Despite the above limitations, the researcher believes that the study has been successfully executed and provides new understanding in the research area studied and sheds light on the under-researched area of IPO issues in Saudi Arabia.

10.8 Further research

A great number of issues were raised in this study requiring further attention. Recognising that this thesis has no precedent in Saudi Arabia, being the first of its kind, it is hoped that it will open new avenues for IPO researchers in the Kingdom to carry out more studies on this essential subject. Studying IPO issues in Saudi Arabia is very important and there are several opportunities for future research.

From the findings and results of this study, some suggestions for future research can be made. Firstly, future researches could strengthen the findings by using a larger number of participants and case studies. They could conduct interviews with government officials to ask their perspective toward IPO activities in the Kingdom.

Secondly, future research could conduct studies to find solutions which would reduce the barriers found in this study. For example, the findings of the study suggest that the most important barrier to going public in the Kingdom is the failure of many joint stock companies listed on the SSM to generate profit. Future research could investigate the reasons behind this failure and suggest solutions, helping these companies to make profits.

Thirdly, future research could focus more on the relationship between the stock market and economic variables. A few studies have investigated the effect of changes in the economic variables on the stock market, but the effect of the size of the stock market on the economy has not been studied enough.

Finally, future research could study how the suggestions provided for the government and organisations which would increase IPOs in Saudi Arabia could be implemented.

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Appendix A: the interview questions

(The single case study)

1. ***What motivated you to switch into a Joint Stock Company?***
2. ***What were the barriers you faced when you decided to go public?***
3. ***What are advantages of being a Joint Stock Company?***
4. ***What are disadvantages of being a Joint Stock Company?***
5. ***The effects of going public:***

A- Our analysis of your financial statements for the period from 1984 to 1992 shows that:

- Most of the profitability ratios went down after the IPO. Could you please explain why the profitability decreased after the IPO?
- Your dependence on external debt decrease significantly after the IPO. Could you please explain if you change your financing strategy after the IPO or did you always intend to use the money raised to pay your debt back?
- The growth ratios show that the company was growing more in the period before the IPO. Could you please explain if the going public decision has had an effect on the growth of the company?
- The liquidity ratios also show that the ability of the company to meet its short-term obligation was better in the period before the IPO. Could you please explain if the IPO has an effect on the liquidity of the company?

B- Could you please explain if you diversified your business after the IPO? If so, why and what was the effect in economic and financial terms?

C- Could you please explain if the ownership structure changed after the IPO? If so, was it intentional or not and what were the consequences?

D- Could you please explain if your position as a Joint Stock Company has helped you become more competitive?

6. ***In your opinion, would an increase in the number of Joint Stock companies affect the Saudi economy? Please explain***
7. ***Do you think going public decision is associated with particular kinds of companies? Please explain***
8. ***Could you please give some suggestions, which would improve the rate of going public?***

(Other CEOs and owners of IPOs, who were willing to participate)

2. ***What motivated you to switch into a Joint Stock Company?***
3. ***What are the barriers you faced when you decided to go public?***
4. ***What are advantages of being a Joint Stock Company?***
5. ***What are disadvantages of being a Joint Stock Company?***
6. ***What are the effects of going public on:***

A- The profitability of the company?

B- The debt level or capital structure of the company?

C- The interest rate payable on debt finance

D- The growth of the company?

E- The diversification of the business?

F- The ownership structure?

G- Competition?

7. ***In your opinion, would an increase in the number of Joint Stock companies affect the Saudi economy? Please explain***
8. ***Do you think going public decision is associated with particular kinds of companies? Please explain***
9. ***Could you please give some suggestions, which would improve the rate of going public?***

Appendix B: The questionnaire survey

Recently, several firms, operating in Saudi Arabia, are seeking public financing through selling their shares to outside investors, which is called an Initial Public Offering (IPO) or "Going Public". Moreover, these firms, which moved to Joint Stock Companies, are called IPOs. Professor Anthony Appleyard and I are conducting a PhD research to find the motivations, the barriers, and the effects of going public in Saudi Arabia.

We think that the most suitable persons who can provide creditable and reliable information about our subject are the managers of the largest firms in the country. Because your company is one of the largest firms in the Kingdom, you are invited to participate in the research project by completing the attached questionnaire.

Finally, ***we ensure that all the data provided by you will be absolutely confidential and will be used just for completing the project***. We thank you in advance for your co-operation and we will be more than happy to provide you with a copy of the final results of this study. After completing the questionnaire, please mail it to us by using the enclosed envelope. If you want to use your own envelope, please mail to us on: Abdulrahman Al-Barrak, PO Box 66364, Al-Hassa 31982, Saudi Arabia. You can also fax it to 03-5306530.

Yours Sincerely,

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University of Newcastle upon Tyne
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Abdulrahman Al-Barrak
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King Faisal University
Saudi Arabia

Section One: Background Information

Please read the following questions and tick the best answer(s) you believe:

1- Your age is?

A- Less than 30 years
B- From 30 to 40 years
C- From 41 to 50 years
D- From 51 to 60 years
E- More than 60 years

2- Your nationality is?

A- Saudi
B- Another nationality. Please specify.....

3- Your position in the company is? (You may choose more than one answer)

A- President (Manager)
B- Vice President
C- Financial Manager
D- Another position. Please specify.....

4- Your highest completed level of education is?

A- Less than Bachelor Degree
B- Bachelor Degree
C- Postgraduate Degree
D- Another degree. Please specify.....

5- Your field of study is?

A- Business (including Accounting, Finance, Marketing etc.)
B- Another subject. Please specify.....

6- Your organisation is specified in?

A- Agriculture
B- Contracting
C- Trading
D- Financing
E- Services
F- Manufacturing
G- Diversified (more than one sector)

7- The legal status of your organisation is?

A- Sole Proprietorship
B- Partnership Company
C- Liability Partnership Company
D- Limited Liability Company
E- Joint Stock Company
F-Another legal status. Please specify .....

8- Your organisation age is?

A- Less than 10 years
B- From 10 to 20 years
C- From 21 to 30 years
D- From 31 to 40 years
E- More than 40 years

9- The number of the employees working in your organisation is?

A- Less than 500 employees
B- From 500 to 1000 employees
C- More than 1000 employees

Section Two: The Motivations and Barriers of Going Public in Saudi Arabia

10- Please indicate how strongly you agree or disagree with each of the following motivations, which encourage owners to take their companies public. Please <u>circle</u> the appropriate number you believe using the scale below:

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

Motivations		*Rate*				
A- Motivations Related to the Original Owners :						
Original owners take their companies public:						
A-1	to liquidate part of their investment	1	2	3	4	5
A-2	to diversify part of their investment	1	2	3	4	5
A-3	to solve the problem of lack of family succession and control	1	2	3	4	5
A-4	to overcome the conflicts accruing between the owners about the leadership	1	2	3	4	5
A-5	when they know that the profitability is about to decline permanently (timing their offerings with high performance to sell their shares at a higher price)	1	2	3	4	5
B- Motivations Related to the Organisations:						
Companies go public to :						
B-1	use the money raised for expansion and growth	1	2	3	4	5
B-2	use the money raised to pay their debt	1	2	3	4	5
B-3	improve their credit rating	1	2	3	4	5
B-4	evaluate and monitor management and employees	1	2	3	4	5
B-5	motivate and create incentives to the management and employees	1	2	3	4	5
B-6	acquire and merge with other companies	1	2	3	4	5
B-7	enhance the company image and publicity	1	2	3	4	5
B-8	be recognised by investors	1	2	3	4	5
B-9	establish a value for the firm	1	2	3	4	5
B-10	attract well qualified personnel	1	2	3	4	5
B-11	make firm's products better known	1	2	3	4	5
B-12	avoid bankruptcy	1	2	3	4	5
B-13	be more competitive	1	2	3	4	5
B-14	enhance their employees status	1	2	3	4	5
C- Motivations Related to the Market:						
Organisations go public:						
C-1	when they are overvalued by outside investors	1	2	3	4	5
C-2	when there is a sharp stock price increase	1	2	3	4	5
C-3	because there are few resources of finance	1	2	3	4	5
C-4	because the competition in their market is severe	1	2	3	4	5
D- Motivations Related to the Regulations:						
Organisations go public because the government:						
D-1	eased the procedures for going public	1	2	3	4	5
D-2	grants more subsidies to joint stock companies	1	2	3	4	5
D-3	reduced the income tax rate	1	2	3	4	5
D-4	has allowed the G.C.C citizens to own stocks in the Saudi Stock Market (SSM)	1	2	3	4	5
D-5	has allowed the foreign investors to participate in the SSM through special funds established by commercial banks	1	2	3	4	5
Other Motivations that have not been mentioned "Please specify":						

11- Please indicate how strongly you agree or disagree with each of the following barriers, which may affect negatively the rate of going public in the Kingdom. Please <u>circle</u> the appropriate number you believe using the scale below:

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

Barriers	***Rate***				
A- Barriers Related to the Original Owners:					
A-1 Owners avoid going public because of the possible negative impacts on their relationships with managers and employees	1	2	3	4	5
A-2 Owners avoid going public because of the possible loss of control	1	2	3	4	5
A-3 Fear of more restrictions on private transactions	1	2	3	4	5
A-4 Lack of experience about the legal and financial points related to the IPO	1	2	3	4	5
B- Barriers Related to the Organisations:					
B-1 The lack of well experienced personnel who can manage companies after transition	1	2	3	4	5
B-2 Fear of the increase of agency costs (Agency costs are the explicit and implicit transaction costs necessary to overcome the natural divergence of interest between agent managers and principal stockholders).	1	2	3	4	5
B-3 External investor scrutiny	1	2	3	4	5
B-4 Dividend pressure	1	2	3	4	5
B-5 Unwelcome attention regarding a possible takeover	1	2	3	4	5
B-6 Fear that the offer price might be less than market price in the first day	1	2	3	4	5
B-7 The difficulty of determining the real value of the organisation	1	2	3	4	5
C- Barriers Related to the Market:					
C-1 Liquidity in the Saudi Market is limited	1	2	3	4	5
C-2 There are a few underwriters	1	2	3	4	5
C-3 There is no complete financial system	1	2	3	4	5
C-4 The SSM is not open completely for international investors	1	2	3	4	5
C-5 The failure of many joint stock companies listed in the SSM to generate reasonable profits	1	2	3	4	5
C-6 Expenses and fees associated with the procedures of going public are high	1	2	3	4	5
D- Barriers Related to the Regulations:					
D-1 Restrictive regulations from the Ministry of Commerce for companies willing to convert into a joint stock company	1	2	3	4	5
D-2 Restrictive regulations from the Department of Zakat and income tax	1	2	3	4	5
D-3 More disclosure requirements	1	2	3	4	5
D-4 The ambiguity in regulations that cover fundamental IPO issues	1	2	3	4	5
D-5 Income tax rate is high	1	2	3	4	5
Other Barriers that have not been mentioned "Please specify"					

Section Three: the Effects of Going Public in Saudi Arabia

12- Do you believe that, after the transition, the profitability of IPOs:

A- Increases (please go to question 13 then jump into 15)

B- Decreases (please go to question 14)

C- Do not change (please go to question 15)

D- Do not know (please go to question 15)

13- If you believe IPOs' profitability <u>increases</u> after the transition, please indicate how strongly you agree or disagree with each of the following factors, which would have positive effects on the IPOs' profitability. Please <u>circle</u> the appropriate number you believe using the scale below:

1 = Strongly disagree, 2 = Disagree, 3 = Neither agree nor disagree, 4 = Agree, and 5 = Strongly agree.

Factors	***Rate***				
A- The change in the ownership structure	1	2	3	4	5
B- IPOs' products and names get more publicity	1	2	3	4	5
C- After transition, IPOs diversify their business	1	2	3	4	5
D- After transition, IPOs grow more	1	2	3	4	5
E- After transition, IPOs hire professional personnel to lead the companies	1	2	3	4	5
F- After transition, management and employees become shareholders giving them more incentives to work harder	1	2	3	4	5
G- Interest rate, that IPOs are charged, decreases	1	2	3	4	5
Other factors that may have positive effects on the IPOs' profitability "Please specify"					

14- If you believe IPOs' profitability <u>decreases</u> after the transition, please indicate how strongly you agree or disagree with each of the following factors, which would have negative effects on the IPOs' profitability. Please <u>circle</u> the appropriate number you believe using the scale below:

1 = Strongly disagree, 2 = Disagree, 3 = Neither agree nor disagree, 4 = Agree, and 5 = Strongly agree.

Factors	***Rate***				
A- IPOs witness changes in the ownership structure	1	2	3	4	5
B- controlling shareholders and the top managers pay their private expenses from the company's money	1	2	3	4	5
C- IPOs witness increases in agency costs which occur due to the increased conflict between the shareholders and the management	1	2	3	4	5
D- The controlling shareholders and top managers give themselves more privileges (increase their salaries, their bonuses. etc)	1	2	3	4	5
E- IPOs invest in long-term projects which payoff after a few years	1	2	3	4	5
F- The original owners time their IPO with high performance	1	2	3	4	5
Other factors that may have negative effects on the IPOs' profitabilities "Please specify"					

15- An increased number of Joint stock Companies would have an effect on the following economical factors. Please express your opinion with that by circling the appropriate number you believe using the scale below:

1 = strong negative effect, 2 = negative effect, 3 = no effect, 4 = positive effect, and 5 = strong positive effect

Factors	*Rate*				
A- Economic growth	1	2	3	4	5
B- The balance of trade (Exports and Imports)	1	2	3	4	5
C- The unemployment rate	1	2	3	4	5
D- The international investments	1	2	3	4	5
E- The competition in the market	1	2	3	4	5
F- The inflation rate	1	2	3	4	5
G- Interest rate	1	2	3	4	5
Other factors that are affected by the increase number of Joint Stock Companies "Please specify"					

Section Five: the Characteristics of Companies Going Public in Saudi Arabia

16- Please indicate how strongly you agree or disagree that the following companies would be more likely to go public. Please circling the appropriate number you believe using the scale below:

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

Company	*Rate*				
A- Large companies (In terms of size)	1	2	3	4	5
B- Old companies (In terms of age)	1	2	3	4	5
C- Very risky companies	1	2	3	4	5
D- Overvalued companies	1	2	3	4	5
E- Well-known companies	1	2	3	4	5
F- Profitable Companies	1	2	3	4	5
G- High growth companies	1	2	3	4	5
H- Manufacturing companies	1	2	3	4	5
I- Companies that are owned by more than one investor	1	2	3	4	5
J- Companies that have a huge amount of debt	1	2	3	4	5
K- Companies that work in very competitive industries	1	2	3	4	5
Other companies that would have relation with going public decision "Please specify"					

Section Six: Suggestions to Improve the Rate of Going Public in Saudi Arabia

17- Please indicate how strongly you agree or disagree with each of the following suggestions, which would improve the rate of going public. Please <u>circle</u> the appropriate number you believe using the scale below:

1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, and 5 = strongly agree

Suggestions	***Rate***				
A- Suggestions to the Organisations					
The decision makers in private organisations should:					
A-1 increase their companies' size to be big enough	1	2	3	4	5
A-2 reshape companies' organisational structure	1	2	3	4	5
A-3 separate management from ownership and hire well-experienced personnel to lead the companies	1	2	3	4	5
A-4 disclose more information about their companies' activities and financial status to the public	1	2	3	4	5
A-5 enroll in some training programmes which may increase their knowledge about the IPO issues	1	2	3	4	5
B- Suggestions to the Government					
The Saudi government should:					
B-1 create complete financial system	1	2	3	4	5
B-2 allow non-Saudi investors to participate freely in the SSM	1	2	3	4	5
B-3 allow banks to invest in the SSM	1	2	3	4	5
B-4 ease the regulations for firms and persons willing to be underwriters	1	2	3	4	5
B-5 allow foreign companies to be listed in the SSM	1	2	3	4	5
B-6 ease the regulations for firms willing to go public	1	2	3	4	5
B-7 grant IPOs more subsidies	1	2	3	4	5
B-8 prepare clear guidelines that explains the procedures for going public	1	2	3	4	5
Other suggestions that have not been mentioned "Please specify"					

Finally, if your company moved from private to public company and you do not have any objection to be interviewed to discuss deeply some of the questions, please give us your contact information:

.....

.....

.....

<u>Thank you so much for completing the questionnaire.</u>

Appendix C: The follow up letter

Approximately three weeks ago, I mailed a questionnaire to you regarding the going public in Saudi Arabia. If you have already filled out and returned the questionnaire, we want in this opportunity to thank you for your co-operations. If not, please complete it as soon as possible and return it to the address provided. Your prompt reply would be highly appreciated.

Yours Faithfully,

Anthony Appleyard
Professor of Accounting and Finance
Business School
University of Newcastle upon Tyne
United Kingdom

Abdulrahman Al-Barrak
Lecturer of Finance
Department of Business
King Faisal University
Saudi Arabia

Appendix D: Letter from the researcher sponsor (King Faisal University)

KINGDOM OF SAUDI ARABIA
Ministry of Higher Education
KING FAISAL UNIVERSITY

المملكة العربية السعودية
وزارة التعليم العالي
جامعة الملك فيصل

الرقم : التاريخ : المرفقات :

إلى من يهمه الأمر

نفيد سعادتكم بأن الأستاذ/عبدالرحمن بن محمد البراك أحد مبتعثي كلية العلـــوم الإدارية والتخطيط بجامعة الملك فيصل إلى جامعة نيوكاسل ببريطانيا للحصـــول على درجة الدكتوراه في الإدارة المالية .

وحيث يتطلب الحصول على إتمام شهادة الدكتوراه تقديم بحث ، عليه نأمل مـــن سعادتكم مساعدة المذكور في الحصول على معلومات من شركتكم الموقرة تفيـد الباحث في إتمام البحث والذي يندرج تحت عنوان "التحول إلى شركة مساهمة : أسباب ومعوقات وآثار" .

شاكرين سلفاً لسعادتكم حسن تعاونكم .

وتقبلوا سعادتكم خالص التحية والتقدير ،،،

عميد كلية العلوم الإدارية والتخطيط

د. ناصر بن سعد القحطاني

جامعة الملك فيصل
كلية
العلوم الإدارية والتخطيط
KING FAISAL UNIVERSITY

جامعة الملك فيصل بالأحساء

الأحساء - ص.ب ٤٠٠ - الفاكس ٨٩١٠٣٩ فيصل أس جي - تلفون ٥٨٠٠٠٠٠ - فاكس ٥٨٠١٢١٣ الدمام ص.ب ١٩٨٢ الفاكس ٨٣١٤٠٢ فيصل أس جي - تلفون ٨٣٧٧٠٠٠ - فاكس ٨٥٧٨٠٤٨

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